COMMITMENT
INTEGRITY
LEADERSHIP

November 29, 2022
Report 2021-046

FACT SHEET

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Proposition 56 Tobacco Tax

The Department of Health Care Services Is Not Adequately Monitoring Provider Payments Funded by Tobacco Taxes

Background

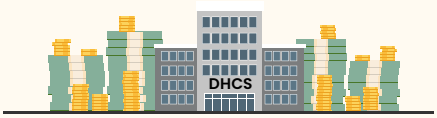
The passage of Proposition 56 enacted the California Healthcare, Research and Prevention Tobacco Tax Act, which raised the State's taxes on a pack of cigarettes by $2. It also requires an equivalent increase in the tax rate on other tobacco products—such as e-cigarettes containing nicotine and chewing tobacco. The majority of Proposition 56 funds, nearly $900 million of the $1.34 billion collected in fiscal year 2020–21, are allocated to increase payments for certain healthcare, treatment, and services provided through the Medi-Cal program.

Key Findings

- The Department of Health Care Services (DHCS) has not provided necessary oversight of Proposition 56 supplemental payments to health care providers.
  - Differences between the supplemental payments that managed care plans reported paying to health care providers and the services that the providers reported delivering to the State's Medi-Cal beneficiaries suggest that the providers do not always receive the supplemental payments to which they are entitled.
  - Some providers receiving Proposition 56 supplemental payments may have engaged in fraudulent activity.
  - DHCS's failure to promptly identify and suspend providers arrested and convicted of certain crimes placed Medi-Cal beneficiaries at unnecessary risk.
- The California Department of Tax and Fee Administration (CDTFA) has not provided adequate oversight of certain tobacco distributors, calling into question whether those distributors paid the appropriate amount of tax on other tobacco products (OTP tax).
  - During its audits, CDTFA generally did not obtain sufficient documentation to substantiate the wholesale costs on which the OTP tax is applied, increasing the risk that the manufacturer-distributors did not pay the correct amount of tax.
- All six entities that we reviewed posted on their websites the Proposition 56 funds they received and spent, as state law requires, but five of them posted either budgetary estimates or inaccurate information.
  - These estimates or inaccuracies make it difficult for the public to determine the amount of funds that the entities actually received and how two of them spent those funds.

Key Recommendations

- The Legislature should permit DHCS and the boards that license Medi-Cal providers to share information about providers' arrests for fraud or abuse.
- DHCS should do the following:
  - Require managed care plans to submit Medi-Cal beneficiary identification information with their quarterly reports, reconcile those reports to medical encounter data, and recover any overpayments.
  - Investigate instances we identified in which managed care plans were unable to provide evidence that medical services were provided.
  - Reduce the amount of time providers subject to mandatory suspension can provide services to Medi-Cal beneficiaries by issuing temporary provider suspensions and temporary payment suspensions when permissible or required by state law.
- CDTFA should obtain sufficient documentation during its audits to verify the accuracy of the amounts on which the OTP tax is applied.
- The entities that receive Proposition 56 funding should ensure the accuracy of the information they provide the public about the amounts they received and spent.



DHCS paid a total of $380,000 for 10,100 services by 14 providers that were on state and federal lists of ineligible providers.

4 of the 14

ineligible providers received payments for 90 percent of these services.

Proposition 56 Tobacco Tax

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REPORT 2021-046

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November 29, 2022
2021-046

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Revenue and Taxation Code section 30130.56, my office conducted an audit of the calculation, distribution, and administration of Proposition 56 tobacco tax funds. We determined that the Department of Health Care Services (DHCS) did not adequately ensure that Proposition 56 supplemental payments (supplemental payments) to health care providers were appropriate. Further, the California Department of Tax and Fee Administration (CDTFA) did not collect sufficient documentation during its audits to determine whether certain tobacco distributors paid the correct amount of tax.

Proposition 56 provided nearly $900 million in fiscal year 2020–21 to DHCS to increase funding for health care services through the State's Medi-Cal program. However, DHCS did not ensure that Medi-Cal managed care plans appropriately issued supplemental payments to the providers that performed services eligible for increased payments. For example, for more than 20 percent of the medical services we reviewed, the managed care plans were unable to provide evidence that providers performed the services, raising concerns about the potential for fraud. Our review of medical claims for services eligible for supplemental payments also found that DHCS paid a total of nearly $380,000 to 14 providers that were listed on state and federal lists of ineligible providers. DHCS processed these supplemental payments in part because it does not receive information that would allow it to take action against providers when they are arrested for certain crimes such as elder abuse and fraud.

We also found that CDTFA has not ensured that distributors who both manufacture or import and also distribute other tobacco products such as cigars and e-cigarettes containing nicotine (manufacturer-distributors) are paying the appropriate amount of other tobacco product tax. CDTFA regulations allow manufacturer-distributors to calculate the costs to which these taxes apply. However, during its audits, CDTFA generally did not obtain sufficient documentation to substantiate the wholesale costs that the manufacturer-distributors reported, increasing the risk that the manufacturer-distributors did not pay the correct amount of tax.

Moreover, although state law requires entities that receive Proposition 56 funds to annually report on their websites the Proposition 56 funds they received and spent, five of the entities we reviewed posted inaccurate information. In the absence of accurate information, the public may find it difficult to determine the amount of funds that the entities actually received and how they spent those funds.

Respectfully submitted,

MICHAEL S. TILDEN, CPA
Acting California State Auditor

Selected Abbreviations Used in This Report

CDC	Centers for Disease Control and Prevention
CDPH	California Department of Public Health
CDTFA	California Department of Tax and Fee Administration
DHCS	Department of Health Care Services
OTP	other tobacco products
UC	University of California

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Summary

Cigarette smoking remains the leading cause of preventable death and disability in the United States. California voters chose to increase taxes on cigarettes and other tobacco products by passing Proposition 56, which enacted the California Healthcare, Research and Prevention Tobacco Tax Act of 2016. Supporters of the proposition stated that it would reduce tobacco use and increase funding for public health programs. Proposition 56 added $2 in taxes per pack of 20 cigarettes and imposed an equivalent tax increase on other tobacco products, such as cigars, chewing tobacco, and e-cigarettes containing nicotine (OTP tax). The tax increase generated more than $1.3 billion in tax revenue in fiscal year 2020–21 alone.

DHCS Has Not Ensured the Appropriateness of Its Proposition 56 Payments and the Effectiveness of Its Provider Suspension Process

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California uses the majority of Proposition 56 funds—nearly $900 million in fiscal year 2020–21—to increase payments for certain types of health care, treatment, and services provided under the Medi-Cal program. The Department of Health Care Services (DHCS) is responsible for administering these funds in accordance with state law. However, our review found that DHCS has not provided the oversight necessary to ensure that the health care providers that deliver services to the State's Medi-Cal beneficiaries always receive the Proposition 56 supplemental payments to which they are entitled. Further, our review suggests that some providers may have engaged in fraudulent activity that resulted in their receiving Proposition 56 supplemental payments, which DHCS indicated it intends to investigate. Finally, our review of fee-for-service claims by providers that received Proposition 56 payments found that DHCS paid a total of $380,000 in both Proposition 56 funds and other Medi-Cal funds to 14 providers that state and federal lists had identified as ineligible. DHCS's failure to promptly cease payments to these providers placed Medi-Cal beneficiaries at unnecessary risk.

CDTFA Has Not Ensured That Certain Tobacco Distributors Are Paying the Appropriate Amount of OTP Tax

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The California Department of Tax and Fee Administration (CDTFA) has not provided adequate oversight of certain tobacco distributors, calling into question whether those distributors paid the appropriate amount of OTP tax on products like cigars. CDTFA regulations allow tobacco product distributors who both distribute certain tobacco products and manufacture or import them (manufacturer-distributors) to calculate the costs to which the taxes apply. However, during its audits, CDTFA generally did not obtain sufficient documentation to substantiate the wholesale costs that manufacturer-distributors reported, increasing the risk that the manufacturer-distributors did not pay the correct amount of tax.

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The Six Entities We Reviewed Posted the Required Proposition 56 Information on Their Websites, but Five Did So Inaccurately

State law requires entities that receive Proposition 56 funds to publicly report each year on the Proposition 56 funds they received and spent. In fiscal years 2019–20 and 2020–21, all six entities that we reviewed—the University of California (UC), the California Department of Public Health (CDPH), the California Department of Justice (Justice), the California Department of Education (Education), DHCS, and CDTFA—posted this information on their websites as state law requires. However, five of them posted either budgetary estimates or inaccurate information, making it difficult for the public to determine the amount of funds that the entities actually received and how two of them spent those funds.

Recommendations

The following are the recommendations we made as a result of our audit. Descriptions of the findings and conclusions that led to these recommendations can be found in the sections of this report.

Legislature

To better protect Medi-Cal beneficiaries, the Legislature should consider amending state law to permit DHCS and the boards that license Medi-Cal providers to execute agreements that would allow those licensing boards to provide DHCS with timely information from the notifications sent to the licensing boards when Medi-Cal providers are arrested and the arrest involves a credible allegation of fraud or indicates the provider is under investigation for fraud or abuse.

DHCS

To ensure that managed care plans pay Proposition 56 supplemental payments to the appropriate providers, DHCS should require managed care plans to submit Medi-Cal beneficiary identification information with their quarterly reports by June 2023. Once DHCS obtains this information, it should reconcile those reports to medical encounter data and then recover any overpayments it identifies.

To ensure that managed care plans issue Proposition 56 supplemental payments only when providers have actually performed the services in question, DHCS should do the following:

- By June 2023, investigate those instances in which managed care plans were unable to provide evidence that the medical services we reviewed were provided. After determining why the managed care plans lacked this evidence, it should use its corrective action plan process to implement additional monitoring and oversight of those managed care plans.

- By June 2023, begin annually selecting a sample of Proposition 56 supplemental payments of a sufficient size to ensure that it can project the results of its review to the population of services that receive supplemental payments, and requesting the underlying medical records to confirm that the services were provided.

To comply with state law, reduce the amount of time it takes to suspend providers from delivering Medi-Cal services, and better protect Medi-Cal beneficiaries from potentially ineligible providers, DHCS should, by June 2023, begin issuing temporary provider suspensions or temporary payment suspensions when permissible or required by state law while it engages in the process of issuing a mandatory provider suspension.

To prevent providers from billing for services performed by other providers that have been suspended, DHCS should, by June 2023, revise its policies and billing system to assess all service-rendering providers included in claim data and verify that they have not been suspended.

To ensure that it reports accurate information to the public, DHCS should institute a more robust management review process for posting Proposition 56 expenditure information on its website beginning with the information it reports for fiscal year 2021–22.

CDTFA

To ensure that other tobacco product manufacturer-distributors pay the appropriate amount of OTP taxes, CDTFA should obtain sufficient documentation to verify the accuracy of those entities' wholesale costs. If these manufacturer-distributors refuse to provide necessary documentation, CDTFA should compel them to do so using the mechanisms existing in state law, such as administrative subpoenas, and it should consider referring them for criminal prosecution.

CDPH

To ensure that it reports accurate information to the public, CDPH should compile the expenditure information for each of its Proposition 56 programs using the same type of accounting report beginning with the information it reports for fiscal year 2021–22.

CDTFA, Education, CDPH, DHCS, and Justice

To provide more accurate information to the public, each entity should report on its website the amount of Proposition 56 funds that it actually received beginning with the information it reports for fiscal year 2021–22.

CDTFA, Education, and DHCS

When CDTFA, Education, and DHCS post information to their websites about the amounts of Proposition 56 funds they have received and spent, they should also post links to that information on their social media platforms to increase transparency.

Department of Finance

To ensure that Education receives its proportional share of Proposition 56 funds, the Department of Finance (Finance) should determine the amount of fiscal year 2017–18 Proposition 56 funds that Education is owed and arrange for the transfer of those funds from CDPH to Education by June 2023.

To ensure that Education can spend the funds that it was allocated in prior fiscal years, Finance should transfer the unspent portion of these funds to an account that Education can access by June 2023. Further, it should inform Education the funds are available to be spent.

Agency Comments

The audited entities generally agreed to implement our recommendations. Some of the entities disagreed with elements of our findings and provided a different perspective regarding their accounting of Proposition 56 funds they received.

Introduction

Background

According to the Centers for Disease Control and Prevention (CDC), cigarette smoking remains the leading cause of preventable death and disability in the U.S., despite a significant decline in the number of people who smoke. In California, smoking-related illnesses cause 40,000 deaths per year, according to data published in 2019—approximately 15 percent of all of the State's deaths in that year.

Since 1959 the State has imposed increasing amounts of taxes on cigarettes, as the text box shows. Beginning in 1989, Proposition 99 required California to impose a tax on the distribution of other tobacco products at a rate equivalent to the combined rate of tax imposed on cigarettes. California voters subsequently raised taxes significantly on cigarettes and other tobacco products when they passed Proposition 56, which enacted the California Healthcare, Research and Prevention Tobacco Tax Act of 2016.[1] That tax increase took effect in April 2017 and has generated more than $1.3 billion in revenue in each of the following fiscal years. Supporters of Proposition 56 believed that the measure would improve public health by increasing the costs of tobacco products and thus discouraging consumers from buying them. Further, the majority of Proposition 56 tax revenue goes to programs associated with public health, which supporters argued would help offset tobacco-related health care costs.

California Cigarette Taxes

	TOTAL PER PACK
1959: Initial cigarette tax of three cents per pack imposed	$0.03
August 1967: Cigarette tax increases by four cents per pack	$0.07
October 1967: Cigarette tax increases by three cents per pack	$0.10
1989: Proposition 99 increases tax by 25 cents per pack	$0.35
1994: Breast Cancer Act of 1993 increases tax by two cents per pack	$0.37
1999: Proposition 10 increases tax by 50 cents per pack	$0.87
2017: Proposition 56 increases tax by $2 per pack	$2.87
Total	**$2.87**

Source: State law.
Note: Taxes are per pack of 20 cigarettes.

Proposition 56 Taxes

Proposition 56 raised taxes on cigarettes and imposed an equivalent tax increase on other tobacco products such as e-cigarettes containing nicotine and chewing tobacco. The text box lists examples of these other tobacco products. The California Department of Tax and Fee Administration (CDTFA) is responsible for collecting these taxes on cigarettes and other tobacco products. Rather than imposing cigarette taxes as a percent of the sales price, Proposition 56 specifies an additional tax of 10 cents per cigarette.

Examples of Other Tobacco Products

- Chewing tobacco
- Pipe tobacco
- Snuff
- Cigars
- E-cigarettes containing nicotine (effective April 1, 2017, as a result of Proposition 56)

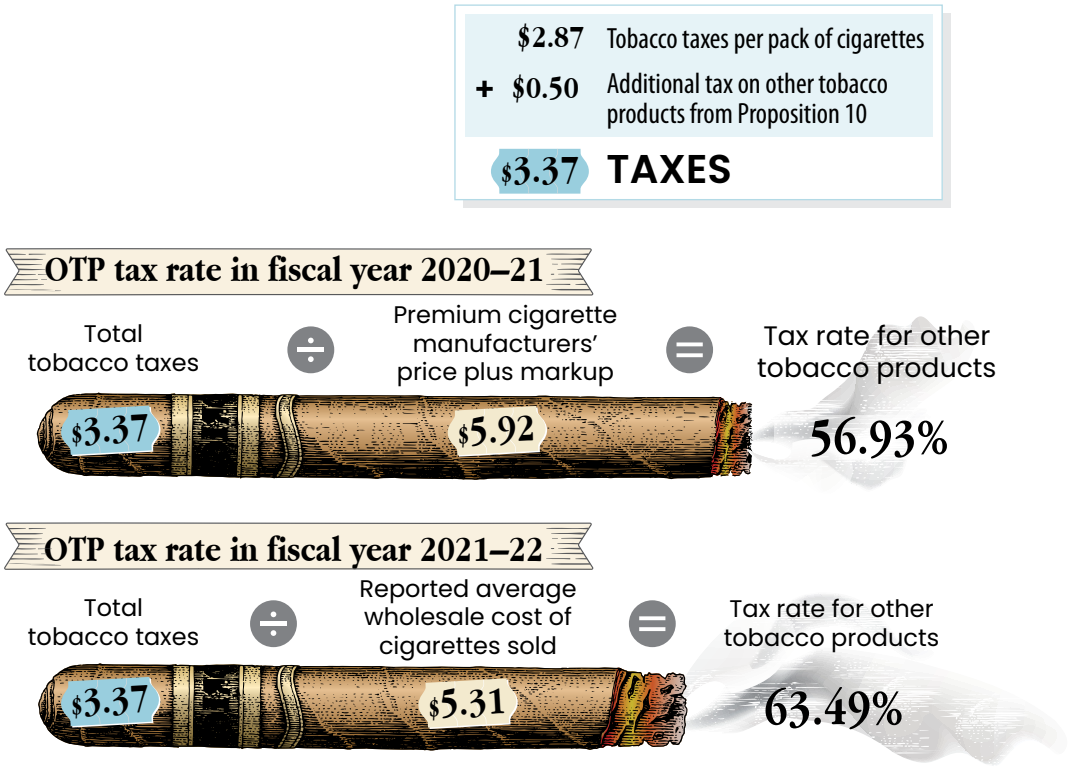
Source: State law.

[1] Throughout this report, we refer to Proposition 56, as approved by the voters at the November 8, 2016, statewide general election, as *Proposition 56*. Similarly, we refer to Propositions 99 and 10, as approved by the voters at the November 8, 1988, and November 3, 1998, statewide general elections, respectively, as *Proposition 99* and *Proposition 10*.

Thus, Proposition 56 increased the State's taxes on a pack of 20 cigarettes by $2 for a total tax of $2.87 as of 2022. Because packs of cigarettes generally contain a standard number of cigarettes—20—distributors pay CDTFA for cigarette tax stamps of specific denominations and attach them to each pack of cigarettes before distributing them to wholesalers, retailers, or other distributors.

In contrast, other tobacco products come in a variety of quantities, sizes, and types, making it less feasible to specify in law a specific tax amount for each individual product. Instead, state law directs CDTFA to apply a tax rate to other tobacco products that is equivalent to the tax rate levied on cigarettes plus an additional amount that is applied only to other tobacco products. From fiscal years 2009–10 through 2020–21, CDTFA used information from a tobacco industry association to determine the average wholesale cost of cigarettes, the basis for its calculation of the tax rate for other tobacco products. However, for the other tobacco product tax rate calculation for fiscal year 2021–22, CDTFA began using the cigarette manufacturers' and importers' reported sales to calculate the average wholesale cost. As Figure 1 shows, CDTFA calculated the annual tax rate for other tobacco products in fiscal year 2021–22 to be 63.49 percent of distributors' wholesale cost.

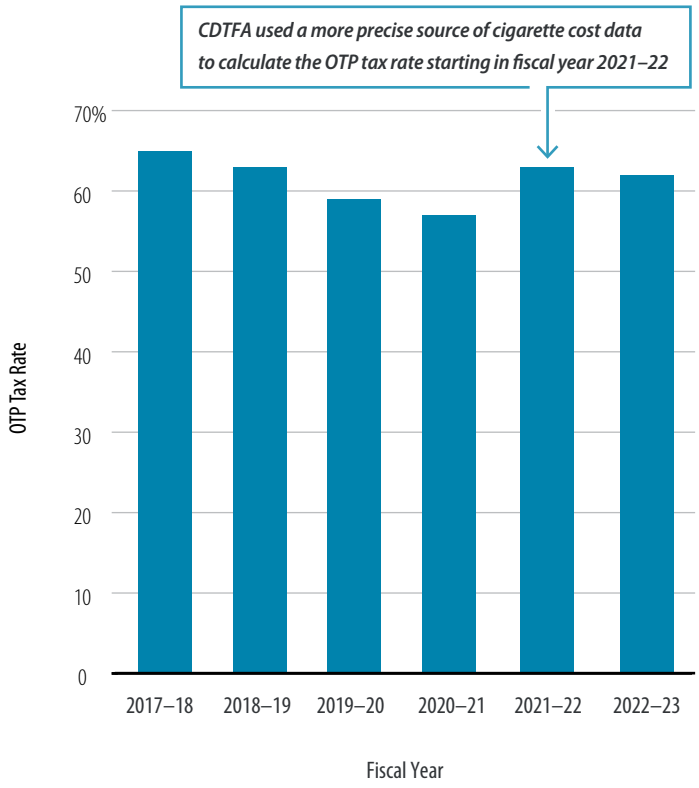
Figure 1
CDTFA Now Bases Its Calculation of the OTP Tax Rate on Reported Cigarette Sales



Source: CDTFA's fiscal year 2021–22 OTP tax rate calculation.
Note: Amounts are per pack of 20 cigarettes.

The OTP tax rate changes from year to year, as Figure 2 shows. This fluctuation occurs because the rate is based, in part, on the wholesale cost of cigarettes, which also changes. Distributors of other tobacco products must use the annual tax rate to determine and pay the taxes they owe on the other tobacco products they distribute. When the wholesale cost of cigarettes rises, the tobacco taxes represent a smaller proportion of cigarettes' total cost, and thus the effective cigarette tax rate decreases. In other words, because the dollar amount of taxes on cigarettes does not change, an increase in the wholesale cost of cigarettes causes a decrease in the effective tax rate. The inverse is true as well: if the wholesale cost of cigarettes should decrease, the effective tax rate would increase.

Figure 2
The Tax Rate on Other Tobacco Products Has Changed Over Time



Source: CDTFA's website and its fiscal year 2021–22 tobacco products tax rate memo.

Distribution and Oversight of Proposition 56 Revenue

CDTFA must deposit revenue collected from the Proposition 56 taxes into the California Healthcare, Research and Prevention Tobacco Tax Act of 2016 Fund (tobacco tax fund). State law specifies how the money in the tobacco tax fund must be allocated. Because the supporters of Proposition 56 believed the additional tax would lead to a decline in tobacco product consumption, Proposition 56 directs CDTFA to annually determine the effect of the imposition of the additional taxes on certain funds that receive tobacco tax revenue.

Funds That Are Backfilled Using Proposition 56 Tobacco Tax Revenue

- **Proposition 10:** California Children and Families Trust Fund
- **Proposition 99:** Cigarette and Tobacco Products Surtax Fund
- Breast Cancer Fund
- State General Fund

Source: State law, *Manual of State Funds*, and the State Controller's appropriation control ledger.

Proposition 56 then directs the State Controller's Office (State Controller) to transfer from the tobacco tax fund the amount necessary to offset any reductions in revenue to those funds that directly result from the imposition of additional taxes by Proposition 56. We describe the portion of Proposition 56 funding that the State Controller transfers to replace the decreased revenue from those other taxes—more than $168 million in fiscal year 2020–21—as the *backfill*. The text box lists the funds that receive the backfill.

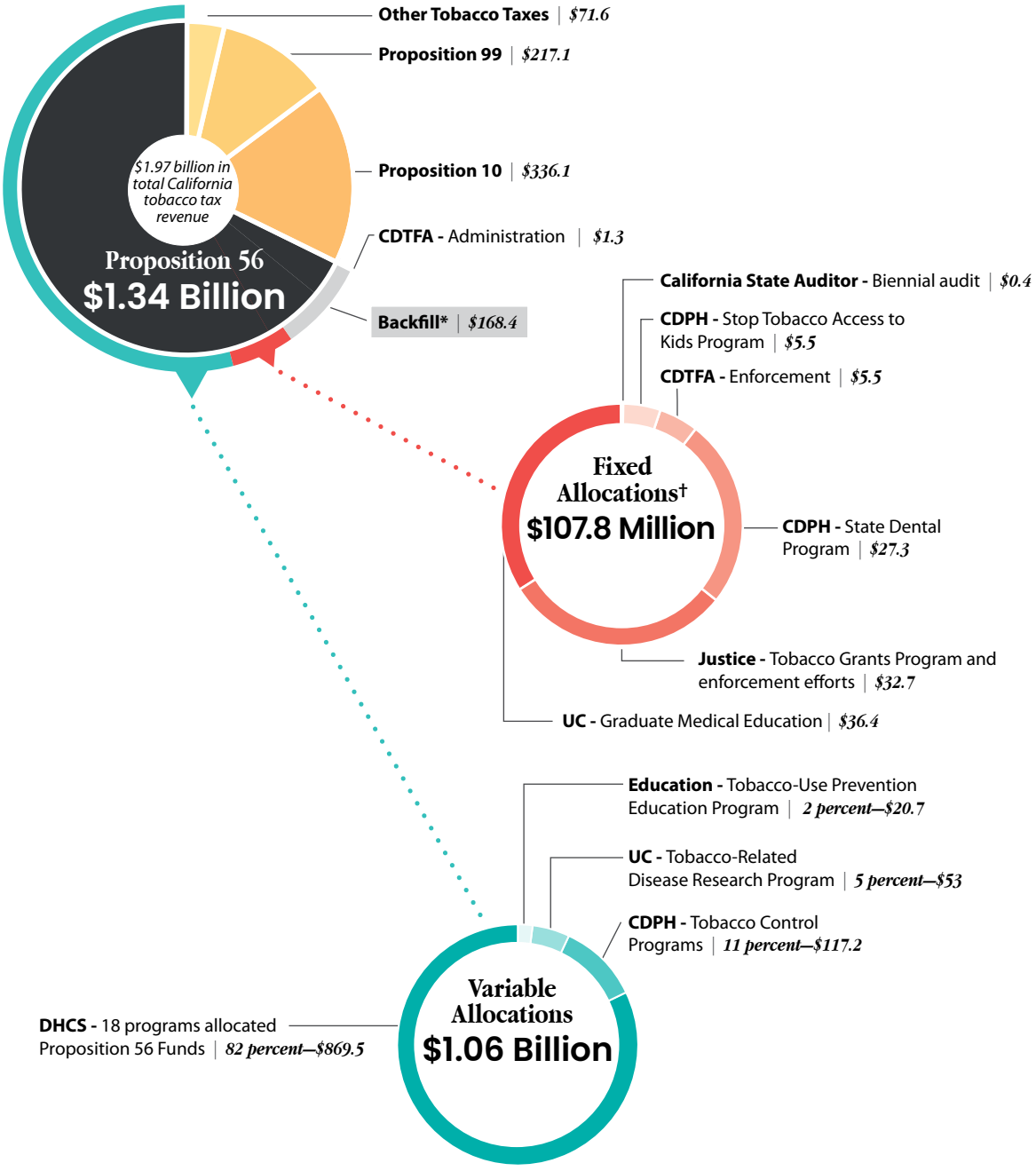
The State Controller must allocate and transfer the remaining revenue in the tobacco tax fund according to requirements in state law. Specifically, following the State Controller's backfill allocations, CDTFA receives a portion of the Proposition 56 revenue for its costs to administer the tax. State law also specifies the state agencies that are to receive specific allocations from the tobacco tax fund, which includes an allocation to reimburse the California State Auditor (State Auditor) for conducting an independent audit, at least biennially, of the agencies receiving Proposition 56 tax revenue.[2] After the State Controller allocates these defined amounts, it distributes the remaining revenue to specified agencies based on percentages established in state law. Figure 3 shows how the law allocated the $1.34 billion in Proposition 56 tobacco tax revenue that CDTFA collected in fiscal year 2020–21.

The law also includes requirements for how the receiving agencies must use this revenue. For example, the University of California (UC) received an allocation of more than $36 million in fiscal year 2020–21 to increase the number of primary care and emergency physicians trained in the State. In deciding how to use these funds, UC must prioritize direct graduate medical education costs for programs serving medically underserved areas and populations, among other requirements.

Finally, state law also establishes requirements regarding oversight and transparency of the state agencies' use of Proposition 56 tax revenue. The agencies may not spend more than 5 percent of their Proposition 56 allocations for administrative costs, and they must annually publish on their websites—and any social media sites they deem appropriate—an accounting of the money they received from the tobacco tax fund and how they spent it.

[2] Proposition 56 directs CDTFA, beginning two years after the date Proposition 56 took effect and annually thereafter, to determine any reduction in revenues resulting from a decrease in consumption of cigarettes and other tobacco products due to the additional taxes imposed by Proposition 56. If there is a reduction in revenue, CDTFA must reduce the specific allocations to the University of California, the California Department of Public Health, the California Department of Justice, and CDTFA by a proportional amount.

Figure 3
California Collected and Allocated $1.34 Billion in Proposition 56 Tobacco Tax Revenue During Fiscal Year 2020–21 (Dollars in Millions Unless Otherwise Specified)


Other Tobacco Taxes | $71.6
Proposition 99 | $217.1
Proposition 10 | $336.1
CDTFA - Administration | $1.3
Backfill* | $168.4
$1.97 billion in total California tobacco tax revenue
Proposition 56
$1.34 Billion
California State Auditor - Biennial audit | $0.4
CDPH - Stop Tobacco Access to Kids Program | $5.5
CDTFA - Enforcement | $5.5
Fixed Allocations†
$107.8 Million
CDPH - State Dental Program | $27.3
Justice - Tobacco Grants Program and enforcement efforts | $32.7
UC - Graduate Medical Education | $36.4
Education - Tobacco-Use Prevention Education Program | 2 percent—$20.7
UC - Tobacco-Related Disease Research Program | 5 percent—$53
CDPH - Tobacco Control Programs | 11 percent—$117.2
Variable Allocations
$1.06 Billion
DHCS - 18 programs allocated Proposition 56 Funds | 82 percent—$869.5

Source: State Controller's financial system, Department of Finance revenue transfer letters, CDTFA's Open Data Portal, interviews with staff at the entities receiving Proposition 56 funds, and state law.

* The backfill is the amount CDTFA distributes to other tobacco tax funds and state and local governments to replace certain tax revenues lost as a result of any decrease in tobacco sales caused by price increases associated with Proposition 56.

† Beginning in fiscal year 2019–20, in accordance with state law, the fixed allocations to UC, CDPH, Justice, and CDTFA were reduced in proportion to the amount that Proposition 56 revenues decreased as a result of the reduction in cigarette and other tobacco product consumption caused by the additional taxes imposed by Proposition 56.

The Medi-Cal System

Proposition 56 was intended, in part, to increase funding for existing health care programs and services that treat all types of cancer, cardiovascular diseases, lung diseases, oral diseases, and tobacco-related diseases and to expand the number of health care providers that treat patients with such diseases and conditions. To this end, Proposition 56 provided nearly $900 million in fiscal year 2020–21 to the California Medical Assistance Program—the State's Medicaid program—known as *Medi-Cal*. Medi-Cal provides health care coverage to low-income individuals and families who meet federal and state eligibility requirements.

The Department of Health Care Services (DHCS) is the state agency responsible for administering Medi-Cal. To assess the use of funds by state agencies receiving Proposition 56 tax revenue, we selected for review during this audit 13 of the DHCS Medi-Cal programs that received Proposition 56 funds in fiscal year 2020–21. The text box lists all of these programs, which generally provide Proposition 56-funded rate increases, directed payments, and supplemental payments—which we collectively refer to as *supplemental payments*—to providers for certain Medi-Cal services.

DHCS Medi-Cal Programs That Were Allocated Proposition 56 Funds in Fiscal Year 2020–21

- Medical Pregnancy Termination Services*
- Family Planning, Access, Care, and Treatment (FPACT)*
- Intermediate Care Facilities for the Developmentally Disabled*
- Physician Services*
- Dental Services*
- AIDS Waiver Program*
- Freestanding Pediatric Subacute Facilities *
- Family Planning Services*
- Nonemergency Medical Transportation *
- Community-Based Adult Services*
- Home Health and Pediatric Day Health Care Services*
- Developmental Screenings*
- Adverse Childhood Experiences (ACEs) Screenings*
- Behavioral Health Integration Incentive Program
- Physician and Dental Loan Repayment Program
- Value-Based Payment Performance Improvement Initiative
- ACEs Aware Initiative
- Hospital-Based Pediatricians

Source: State law, Department of Aging website; state plan amendments approved by the Centers for Medicare and Medicaid Services; interviews with DHCS staff; and DHCS's all-plan letters, website, capitation rate development and certification documentation, and budget documentation.

* Programs we selected for review.

The State provides Medi-Cal benefits primarily through a managed care delivery system. Individuals who have been determined eligible for Medi-Cal are referred to as *beneficiaries*, and DHCS contracts with managed care health plans (managed care plans) and pays them a flat amount each month to provide health care to each Medi-Cal beneficiary covered by the plan. DHCS is then responsible for overseeing the managed care plans' compliance with the terms of their contracts. The managed care plans subcontract with health care providers, such as primary care physicians, pharmacies, and hospitals, to deliver Medi-Cal-covered services to beneficiaries. As of November 2021, more than 80 percent of Medi-Cal beneficiaries were enrolled in managed care plans.

The remaining Medi-Cal beneficiaries were enrolled in the fee-for-service program. Under this delivery system, Medi-Cal providers submit claims for payment that are adjudicated, processed, and paid or denied. According to an associate governmental program analyst in the operations management branch of DHCS's California Medicaid Management Information System division, DHCS creates, implements, and monitors processes to ensure that its fiscal intermediary pays claims appropriately for services performed by providers.

DHCS Has Not Ensured the Appropriateness of Its Proposition 56 Payments and the Effectiveness of Its Provider Suspension Process

Key Points

- Our review found that DHCS does not have assurance that managed care plans made Proposition 56 supplemental payments to the appropriate providers. The managed care plans were unable to find the medical records for nearly half of a selection of 60 medical services they claimed Proposition 56 supplemental payments for, indicating that the information contained in the managed care plans' systems was inaccurate and may have resulted in their not paying the appropriate provider.

- Our review of another selection of services identified potentially fraudulent activity. For more than 20 percent of the 149 medical records we selected for review, managed care plans could not or did not provide documentation that the service was performed. The managed care plans' inability to provide documentation or sufficient explanation for why they did not have these records suggests that some of the providers may not have actually performed the reported procedures.

- Our review of fee-for-service claims by providers of services that received Proposition 56 supplemental payments found that DHCS paid a number of claims submitted by ineligible providers. DHCS did not suspend these providers in a timely manner because it does not obtain information that would allow it to take action against providers when they are arrested. As a result, it has unnecessarily increased the risk that these providers may harm Medi-Cal beneficiaries.

DHCS Does Not Adequately Monitor Managed Care Plans to Ensure That They Correctly Issue Supplemental Payments to Providers

DHCS provides relatively little oversight of the services performed through the managed care delivery system. Instead, it requires managed care plans to ensure that their providers are eligible to receive Medi-Cal reimbursements and that appropriate processes are used to review and approve the provision of medically necessary covered services. As we discuss in the Introduction, DHCS pays the managed care plans a specific amount per month for each beneficiary enrolled with them, which we refer to as the *flat rate*. Similarly, instead of making supplemental payments to managed care plan providers when they provide a designated Proposition 56 service, DHCS includes Proposition 56 payments in the managed care plans' flat rates. When a provider performs a service eligible for a Proposition 56 supplemental payment, DHCS requires the managed care plan to pay the supplemental amount to the provider.

Examples of Services Provided Through Medi-Cal for Which Providers Receive Proposition 56 Supplemental Payments

SERVICE DESCRIPTION	SUPPLEMENTAL PAYMENT AMOUNT PER SERVICE
Developmental screenings	$59.90
Nonemergency advanced life support ambulance transportation	$10.72
Contraceptive patch	$110.00
Office visit of 30 to 44 minutes for a new patient	$43.00

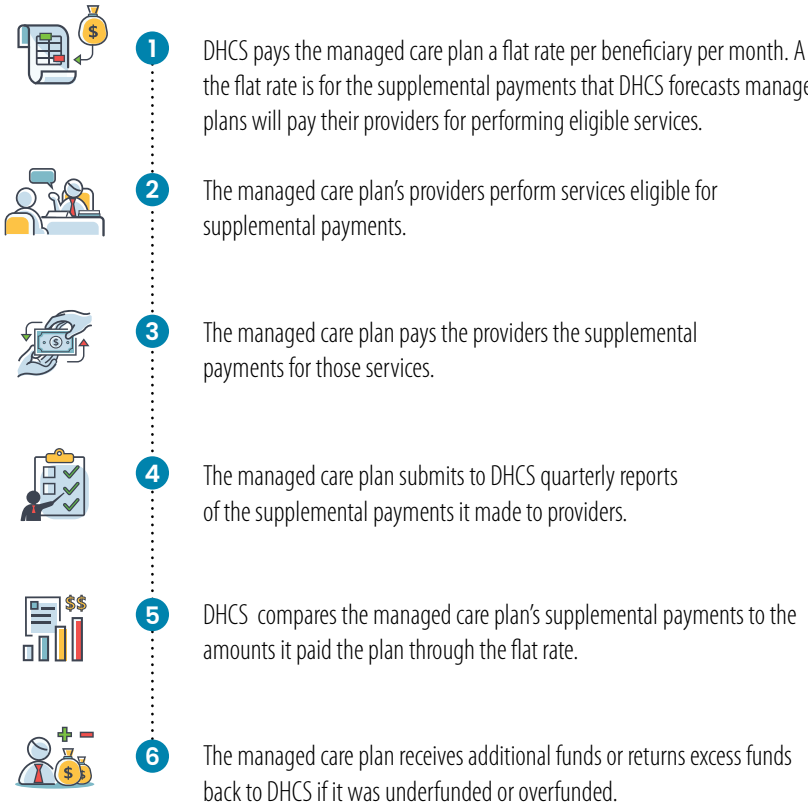
Sources: Medicaid state plan amendments, DHCS policy, and the Centers for Medicare and Medicaid Services' and the American Medical Association's websites.

We reviewed five of the programs for which managed care plans reported making supplemental payments to providers, including physician services and developmental screenings. According to data provided by a DHCS budget supervisor, the department spent more than $525 million on these five programs during fiscal year 2020–21. The text box shows some of the services for which providers receive these supplemental payments.

DHCS does little to ensure that managed care plans are issuing supplemental payments for certain health care, treatment, and services to the appropriate providers. At the end of each quarter, each managed care plan must submit to DHCS a report listing all the supplemental payments it made, the type of service, the provider that rendered the service, and the month the service was provided. According to the unit chief of the financial management section in DHCS's capitated rates development division (unit chief), DHCS compares the supplemental payment amount paid through the managed care flat rate payments to the dollar amounts that managed care plans report they have paid to providers. He explained that during the comparison process, DHCS addresses any discrepancies between these two amounts outside of a predetermined range. If there are discrepancies outside of this range, it requires the managed care plans to return the excess supplemental payment amount or receive additional funding, as Figure 4 shows.

However, DHCS has performed this reconciliation only for fiscal year 2018–19, and our more detailed review found that DHCS has not ensured that managed care plans made supplemental payments to the appropriate providers. When we reconciled the medical services provided to Medi-Cal beneficiaries (medical encounters) to the managed care plans' quarterly reports for fiscal years 2019–20 and 2020–21, we found significant discrepancies. These discrepancies suggest that the managed care plans did not pay the correct provider or did not correctly record information about the service, such as its date or the provider that actually rendered it. Specifically, 17 percent of the services in the fiscal year 2019–20 quarterly reports and nearly 22 percent of those in the fiscal year 2020–21 reports did not have matching records in the providers' medical encounter data. Further, because the quarterly reports did not include beneficiary identification numbers, we were unable to determine whether a service described in the quarterly reports corresponded with a specific medical encounter entry.

Figure 4
DHCS Must Monitor the Amount Managed Care Plans Pay to Providers to Ensure That It Recoups Overpayments to the Plans


1
DHCS pays the managed care plan a flat rate per beneficiary per month. A portion of the flat rate is for the supplemental payments that DHCS forecasts managed care plans will pay their providers for performing eligible services.
2
The managed care plan's providers perform services eligible for supplemental payments.
3
The managed care plan pays the providers the supplemental payments for those services.
4
The managed care plan submits to DHCS quarterly reports of the supplemental payments it made to providers.
5
DHCS compares the managed care plan's supplemental payments to the amounts it paid the plan through the flat rate.
6
The managed care plan receives additional funds or returns excess funds back to DHCS if it was underfunded or overfunded.

Source: DHCS staff.

DHCS's chief data officer indicated that it might take up to 15 months after the end of the period it is evaluating for encounter data to be submitted by managed care plans and accessible to DHCS. However, delays in medical encounter data submission do not explain all of the discrepancies we identified. We reviewed medical encounter data from fiscal year 2019–20, which ended about two years before we received the data, yet we still found that 17 percent of the services from the quarterly reports did not match provider records in the encounter data. Further, for 60 services managed care plans included in their quarterly reports, we asked DHCS to request that the managed care plan identify all of the encounter records that matched the reported provider, procedure code, and date and then explain any discrepancies. The managed care plans provided responses for 47 of the 60 services we selected. However, they indicated they were unable to find any relevant records in 16 of those 47 instances. Thus, we did not receive information for nearly half of the services we selected, raising significant concerns about the information in the plans' systems and the accuracy of their payments.

A DHCS financial management section chief in the capitated rates development division (section chief) stated that there are multiple points in the data submission process where inconsistencies may be introduced that would prevent the encounter data from matching

with the quarterly reporting data. For example, there may be a layered relationship where one managed care plan may provide services under a contract with another managed care plan. However, as we previously indicate, part of the reason that DHCS is unable to determine whether managed care plans are correctly paying providers is because it currently does not require the plans to include beneficiary identification numbers in their quarterly reports.

According to the section chief, DHCS plans to require that managed care plans include the beneficiaries' identification number in their quarterly reports beginning in May 2023. The section chief expects to see an improvement in quality of the encounter data when DHCS can use the beneficiary information to match quarterly data to encounter data on a one-to-one basis. The section chief also stated that DHCS will have greater assurance that the managed care plans are paying their providers appropriately when it requires them to provide this information. Until then, according to the section chief, DHCS will continue to rely on managed care plans to ensure that they pay the right providers and believes that providers will inform DHCS if they do not receive the supplemental payments. However, if providers must monitor whether they receive supplemental payments and contact DHCS when they do not, they may not have a strong incentive to provide the services for which DHCS makes supplemental payments available.

Providers May Have Received Supplemental Payments for Services They Did Not Perform

For many of the services we reviewed, the *managed care plans were unable to provide evidence that their providers performed the medical procedures, which may be indicative of fraudulent activity.* Because DHCS does not require managed care plans to include beneficiary information in their quarterly reports, it is not possible to identify the specific record in the encounter data that matches each record for which a managed care plan claimed a supplemental payment in the quarterly reports. Thus, we used quarterly reports to select a sample of records for which managed care plans asserted they had made supplemental payments to providers. To determine whether these providers performed the procedures for which they may have received Proposition 56 supplemental payments, we then selected 149 encounter records that matched the selections' data elements, such as the type of procedure, date of service, managed care plan, and provider.[3]

We then asked managed care plans to submit medical records for the selected beneficiaries to determine whether the provider performed the procedures we selected for review. State law requires each provider of health care services under the Medi-Cal program to maintain records of each service provided through Medi-Cal. However, in more than 20 percent of the encounters we selected for review, the managed care plans could not or did not provide documentation that the provider performed the service. Of the 149 records that we selected, managed care plans provided responses for 147. However, in two instances, the plans could

[3] Because the quarterly reports do not have sufficient detail to definitively match them to the services described in the encounter data, we could not use them to confirm that providers received Proposition 56 supplemental payments for the services we selected from the encounter data. Nevertheless, we used the records in the encounter data because the quarterly reports did not contain sufficient information for us to identify the beneficiary whose medical records were needed to confirm that the service was provided.

not find any records of the beneficiaries. Further, in an additional 34 instances, the plans did not provide documentation that the medical service described in the encounter record had occurred.

Because providers are required to maintain such records, we requested that DHCS direct the managed care plans to explain why they could not find the relevant documentation. In four of the 34 instances, the plans subsequently provided satisfactory evidence that their providers had rendered the selected service, and in 11 other instances, they provided the explanations the text box lists for their inability to provide these records. As we previously describe, the DHCS section chief stated that inconsistencies may be introduced in multiple points in the data submission process, such as when one managed care plan provides services under a contract with another managed care plan.

Examples of Managed Care Plans' Explanations for Their Inability to Supply Records for the Services They Reported Providing

Managed Care Plan A stated that it was unable to provide nine medical records because it did not keep those records itself. Managed Care Plan A subcontracts with Managed Care Plan B to serve some patients. Managed Care Plan B did not retain records for certain services, and it consequently requested that the physician medical groups and independent physician associations to which it delegates responsibility contact physicians for the medical records. As of October 2022, DHCS had not received any additional information from Managed Care Plan A.

In another example, a DHCS associate management auditor stated that DHCS investigated and confirmed that the two encounters reported by Managed Care Plan C were for services that were in fact provided by Managed Care Plan D and Managed Care Plan E. DHCS concluded that this was most likely the result of poor recordkeeping by the provider and the managed care plans but that it was not indicative of fraud. However, DHCS did not provide us with documentation proving that these services were provided.

Source: Interviews and documentation obtained from DHCS staff and a letter from a managed care plan.

In addition, we have concerns about 19 other instances. In four of these instances, the managed care plans did not provide a sufficient explanation for why they were unable to obtain the medical records. For example, a managed care plan stated that it attempted to collect the medical record from the provider for one claim, but the provider was unable to produce that record or explain why it submitted the claim. Another managed care plan stated that the clinic at the address the provider listed as the location at which he practices informed the plan that the provider did not practice there. In the 15 other instances, the managed care plans did not respond to the requests for additional information; thus, we do not know why they were unable to provide documentation for the services in question. The managed care plans' inability to provide documentation or a sufficient explanation for why they did not have the relevant records presents a concern that providers may not have actually performed the procedures.

According to a DHCS audit coordinator, the managed care plans' inability to provide evidence that these services were provided could have been caused by a combination of poor recordkeeping and possibly fraudulent activity; however, he stated DHCS could not know for certain unless it investigated further. The assistant branch chief of DHCS's contract and enrollment review division indicated that DHCS does intend to investigate these instances.

Whether these managed care plans issued supplemental payments for fraudulent services or simply did not maintain sufficient records, DHCS should use its existing oversight processes to require that the plans address their inability to prove that these services were provided. When a managed care plan fails either to comply with applicable federal and state laws and regulations or to meet its contractual obligations, DHCS can require that it

create and submit a corrective action plan to correct its deficiencies. Moreover, in some situations, DHCS may also impose monetary sanctions. If DHCS requires a managed care plan to complete a corrective action plan, the managed care plan must complete it within the time frame DHCS specifies and must provide supporting documentation and monthly status updates that demonstrate the steps it is taking to correct the deficiency.

We reviewed two corrective action plans that DHCS previously required managed care plans to complete after it found deficiencies in those managed care plans' recordkeeping. The corrective action plans required the managed care plans to implement new processes, provide additional oversight, and deliver training to address the deficiencies. The same types of corrective actions may be necessary to address the issues we identified; however, DHCS must first determine why the managed care plans were unable to locate these records.

Types of Provider Suspensions

Mandatory Provider Suspension: State law requires DHCS to suspend providers for the following reasons:

1. Conviction of any felony or any misdemeanor involving fraud; involving abuse of the Medi-Cal program or any patient; or otherwise substantially related to the qualifications, functions, or duties of a provider of service.
2. Notification from the U.S. Department of Health and Human Services that the physician or other individual practitioner has been suspended from participation in the Medicare or Medicaid programs.
3. Revocation or suspension of a license, certificate, or other approval to provide health care by a federal, California, or another state's licensing, certification, or approval authority. This category also encompasses the loss of a license, certificate, or approval for any other reason and the surrender of a license, certificate, or approval while a disciplinary hearing on that license, certificate, or approval was pending.

Temporary Payment Suspension: State law requires DHCS to temporarily suspend payments to providers when it receives a credible allegation of fraud and an investigation is pending against the provider under the Medi-Cal program unless DHCS has determined that there is a good-cause exception not to suspend payments or to only suspend them in part.

Temporary Provider Suspension: If DHCS discovers that the provider is under investigation for fraud or abuse, state law allows it to issue a temporary suspension of the provider from Medi-Cal, which includes deactivation of the provider's identification number.

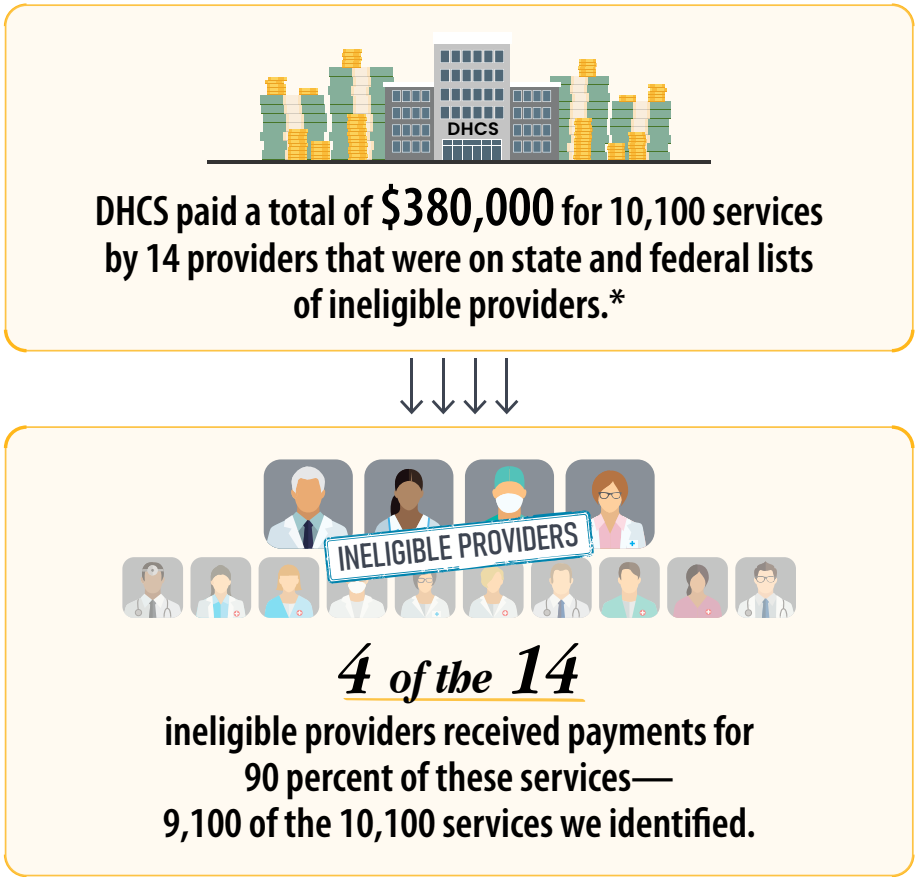
Source: State law.

DHCS's Provider Suspension Process Does Not Adequately Protect Medi-Cal Beneficiaries

As we describe in the Introduction, some of the services for which DHCS issues supplemental payments are also provided through the fee-for-service model. However, DHCS's data indicate that during fiscal years 2019–20 and 2020–21, it made payments to 14 fee-for-service providers after it deemed them ineligible. In certain circumstances, state law requires DHCS to suspend a provider from participation in the Medi-Cal program (mandatory provider suspension), requires it to temporarily suspend payments to providers (temporary payment suspension), or allows it to temporarily suspend a provider (temporary provider suspension). We describe some of these circumstances in the text box. Our review of fee-for-service claims for services eligible for Proposition 56 supplemental payments found that DHCS had paid a total of nearly $380,000 for 10,100 services claimed by 14 providers that were

listed on state and federal lists of ineligible providers, as Figure 5 shows.[4] Four of the 14 ineligible providers received the majority of these payments—9,100 of the 10,100 services we identified.

Figure 5
DHCS Paid 14 Providers Hundreds of Thousands of Dollars in Fiscal Years 2019–20 and 2020–21 After the Dates It Reported Deeming Them Ineligible to Participate in the Medi-Cal Program


DHCS
DHCS paid a total of $380,000 for 10,100 services by 14 providers that were on state and federal lists of ineligible providers.*
INELIGIBLE PROVIDERS
4 of the 14
ineligible providers received payments for 90 percent of these services—9,100 of the 10,100 services we identified.

Source: DHCS provider and claims data.

* This amount includes both the supplemental payments and the standard payments for the services in question.

When we investigated these four providers, we found that in some cases the services were performed after the date DHCS had issued a mandatory provider suspension because DHCS had, in fact, retroactively suspended the provider. According to state law, a mandatory suspension because of the conviction of a provider begins on the date the director of DHCS orders it; the law does not provide for retroactive suspensions

[4] DHCS told us that a small number of these claims could be allowable under certain circumstances, such as when a provider's suspension did not apply to services at all locations where the provider operated.

in these circumstances. DHCS's retroactive suspensions essentially obscured the fact that it had failed to suspend the providers in a timely manner, resulting in additional payments to those providers and potential endangerment to Medi-Cal beneficiaries.

DHCS typically takes a significant amount of time to issue mandatory provider suspensions. According to its records, the department took more than five months on average to process the mandatory provider suspensions it issued from January 2019 through January 2022. Moreover, for the four providers we reviewed, DHCS took an average of nearly 10 months to issue the mandatory provider suspensions. During this period, it reimbursed these four providers $131,000 for more than 4,100 services, an amount that includes both supplemental payments and standard payments.

In one example, the California Department of Justice (Justice) notified DHCS of a provider's conviction for grand theft and elder abuse in October 2020; however, DHCS did not implement the mandatory provider suspension until January 2021. Although DHCS processed this suspension within four months, the provider rendered another 2,200 services during this period, for which he received nearly $50,000 in additional reimbursement from DHCS. According to an attorney in DHCS's office of legal services, the department's process for mandatory provider suspensions includes a number of steps, including verifying information about the providers and their convictions. She also asserted that the unit responsible for processing mandatory suspensions has had fewer staff than in years past. However, *when DHCS does not implement mandatory provider suspensions promptly, it exposes Medi-Cal beneficiaries to additional risk.*

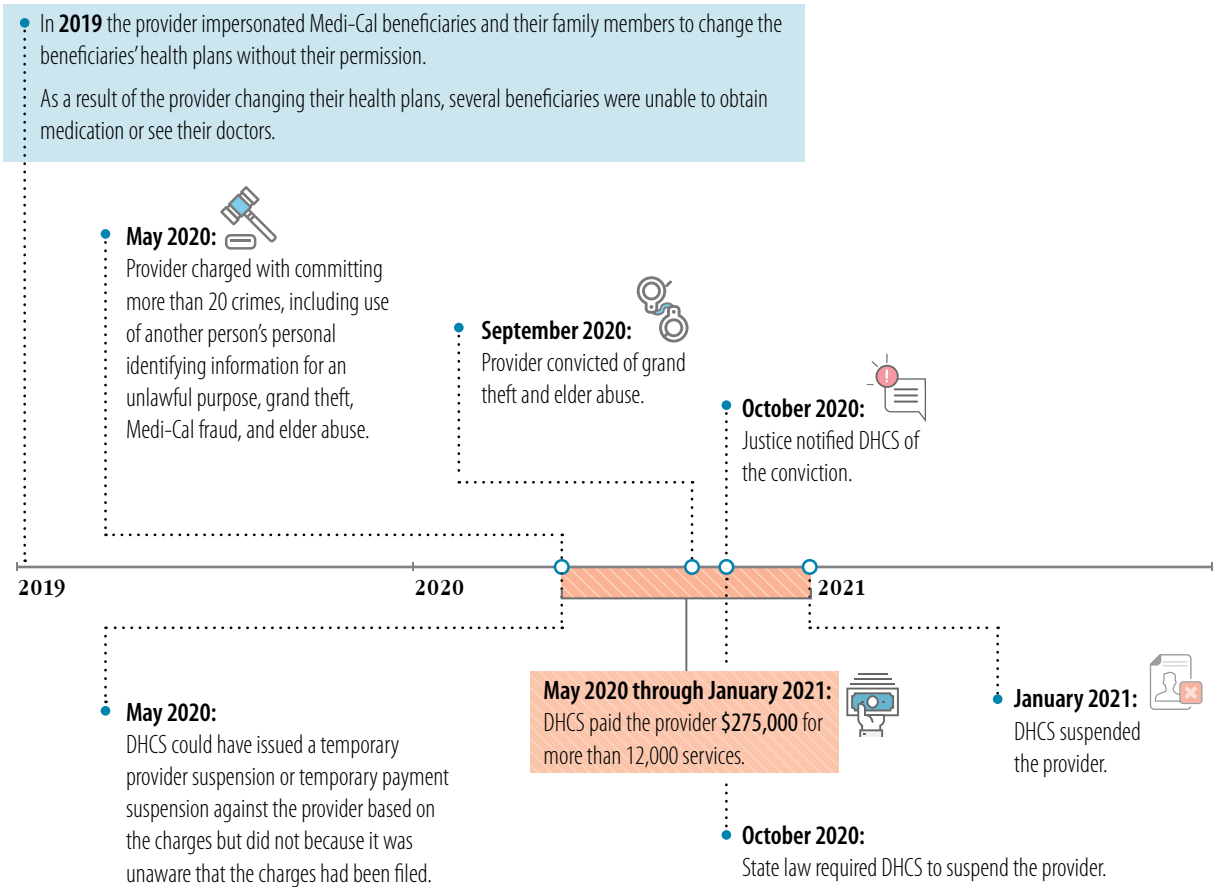
Further, DHCS failed to issue temporary payment suspensions to providers when state law required it to do so—an action that could have reduced the number of reimbursements it issued to these providers. State law requires DHCS, in certain situations, to place a provider under temporary payment suspension when it receives a credible allegation of fraud against a provider for which an investigation is pending under the Medi-Cal program. A credible allegation of fraud may include conviction of a crime involving fraud. State law also allows DHCS to issue a temporary provider suspension if it becomes aware that a provider is under investigation for fraud or abuse. Such circumstances may include when it is conducting an internal investigation to determine whether a provider who has been convicted of a crime involving fraud or abuse should be mandatorily suspended.

Nonetheless, the chief of DHCS' Sanctions Section said that if another unit is processing a mandatory suspension for a convicted provider, DHCS generally does not issue a temporary provider suspension or temporary payment suspension because these processes may take the same amount of time. However, she also told us that the Sanctions Section takes only about two months on average to issue a temporary provider suspension or temporary payment suspension, in contrast to the more than five months DHCS takes on average to issue a mandatory provider suspension. Shortening this time frame by even a few months could reduce the risk such providers pose to Medi-Cal beneficiaries. Further, DHCS can issue temporary payment suspensions and temporary provider suspensions before providers' convictions. In a two-year period, DHCS issued mandatory suspensions to nearly 1,700 providers. However, a mandatory suspension does not take effect until after the provider is

convicted. Thus, issuing temporary payment suspensions as state law requires or temporary provider suspensions as state law allows would have positioned DHCS to better protect beneficiaries.

For example, in the case of the provider we previously discuss, DHCS could have imposed a temporary provider suspension or a temporary payment suspension as early as May 2020—the month when Justice charged the provider with multiple crimes involving fraud, including grand theft, Medi-Cal fraud, and elder abuse. From the date of the charges in May 2020 through the date that DHCS formally issued a suspension in January 2021, this provider delivered more than 12,000 services, for which DHCS paid him $275,000, as Figure 6 shows. DHCS similarly did not impose a temporary provider suspension or temporary payment suspension on two other providers we identified as having been charged with crimes that DHCS ultimately determined involved fraud. DHCS reimbursed these providers nearly $150,000 for about 4,800 services.

Figure 6
A Provider Continued to Deliver Medi-Cal Services for Eight Months After He Was Charged With Multiple Crimes


In 2019 the provider impersonated Medi-Cal beneficiaries and their family members to change the beneficiaries' health plans without their permission.
As a result of the provider changing their health plans, several beneficiaries were unable to obtain medication or see their doctors.
May 2020:
Provider charged with committing more than 20 crimes, including use of another person's personal identifying information for an unlawful purpose, grand theft, Medi-Cal fraud, and elder abuse.
September 2020:
Provider convicted of grand theft and elder abuse.
October 2020:
Justice notified DHCS of the conviction.
2019
2020
2021
May 2020:
DHCS could have issued a temporary provider suspension or temporary payment suspension against the provider based on the charges but did not because it was unaware that the charges had been filed.
May 2020 through January 2021:
DHCS paid the provider $275,000 for more than 12,000 services.
January 2021:
DHCS suspended the provider.
October 2020:
State law required DHCS to suspend the provider.

Source: State law, court documents, and DHCS staff.

According to the chief of the Sanctions Section, DHCS did not implement either form of temporary suspension for these three mandatory provider suspensions we reviewed that resulted from convictions because it was not aware of the criminal charges. DHCS was unaware of these charges because it is neither required to nor does it conduct criminal background checks on the vast majority of providers. Conducting such criminal background checks would allow it to receive notifications of subsequent arrests or dispositions against providers.

Although DHCS has the authority to require providers to obtain criminal background checks, some Medi-Cal providers are already required to obtain them by other entities. Specifically, many state licensing boards, such as the Medical Board of California, Dental Board of California, and California State Board of Pharmacy, require their applicants to undergo criminal background checks. These checks enable the boards to receive subsequent notifications of arrests and dispositions against the individuals. According to state law, a person authorized by law to receive state summary criminal history records or information cannot knowingly share those records or that information with someone not authorized by law to receive it. However, if DHCS were able to implement agreements with the state licensing boards to share such information, it could receive timely notice of the arrests of some providers when the arrest involves a credible allegation of fraud or indicates the provider is under investigation for fraud or abuse. This notification would enable DHCS to determine whether to impose a temporary payment suspension or temporary provider suspension against such providers when warranted.

DHCS's failure to regularly issue temporary payment suspensions and temporary provider suspensions and its inability to obtain criminal history information from licensing boards might be placing a significant number of Medi-Cal beneficiaries at risk of receiving services from providers that DHCS should have suspended. We analyzed only 12,000 of the nearly 100,000 providers on state and federal lists of ineligible providers because many of the providers on the lists lack a unique identifier to link them to the claims with which they are associated. Further, our review was limited to providers of Proposition 56 services, even though our findings have ramifications that extend beyond the services eligible for supplemental payments. We therefore believe that a significant number of additional instances may have occurred in which the amount of time that DHCS took to respond to providers' convictions exposed Medi-Cal beneficiaries to unnecessary risk.

Finally, we found that in certain circumstances, DHCS did not check whether providers who rendered Medi-Cal services were suspended, resulting in inappropriate reimbursements. Specifically, DHCS reimbursed claims for services by six of the 14 suspended providers we identified who rendered services after their dates of suspension. State law prohibits any provider from billing for any service or supply rendered by a provider who is suspended or revoked from being a Medi-Cal provider, and the law allows DHCS to suspend any provider that does so. According to DHCS staff, its billing system did not check in these cases whether the provider who rendered the service (rendering provider) was suspended. DHCS's policy requires the billing system to check if a rendering provider is on the suspended list only if a claim is submitted by a provider who is identified as billing on behalf of

multiple providers. In all other instances, the system does not check the status of the rendering provider. However, to ensure that it does not inappropriately pay rendering providers, DHCS's system should check the status of all rendering providers.

Please refer to the section beginning on page 3 to find the recommendations that we have made as a result of these audit findings.

CDTFA Has Not Ensured That Certain Tobacco Distributors Are Paying the Appropriate Amount of OTP Tax

Key Points

- CDTFA has not obtained sufficient documentation to substantiate the reported costs of certain distributors' other tobacco products. As a result, it does not have assurance that those distributors accurately reported the costs to which the OTP tax rate was applied.
- In response to our 2021 audit, CDTFA used a new, more precise source of data for calculating the fiscal year 2021–22 OTP tax rate. We estimate that this change resulted in the State collecting $45 million in additional OTP taxes in fiscal year 2021–22.

CDTFA Has Not Conducted Sufficiently Detailed Audits to Ensure That Certain Tobacco Distributors Are Paying the Correct Amount of OTP Taxes

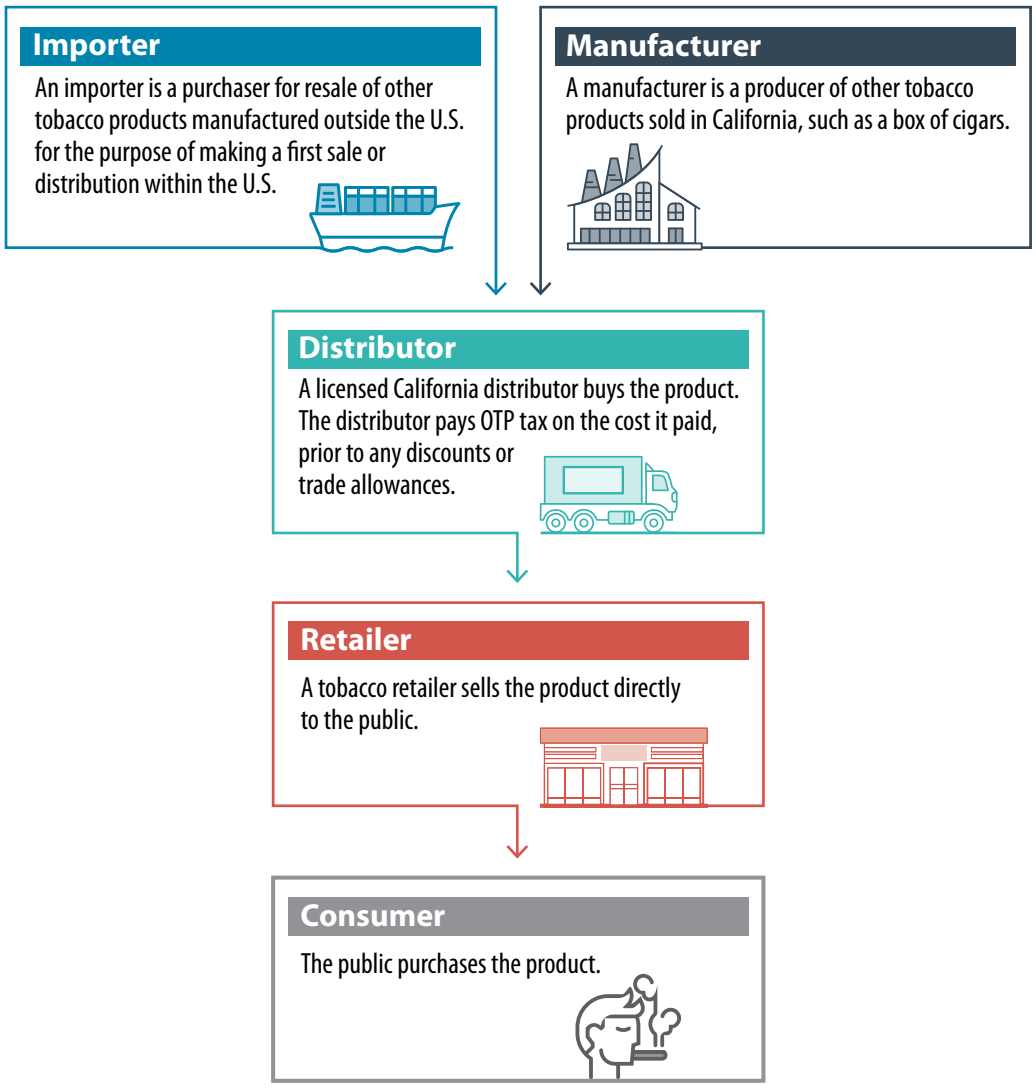
A number of different entities are involved in the process of manufacturing, distributing, and selling other tobacco products to consumers. As the Introduction explains and Figure 7 shows, the State bases OTP taxes on the wholesale cost of other tobacco products. State regulations clarify how to calculate this wholesale cost depending on the relationship between the entities involved in distributing the products. If distributors purchase finished other tobacco products from a supplier in what is referred to as an *arm's-length transaction*, the wholesale cost is the price that they pay for the product, plus any discounts and trade allowances and less any transportation charges for shipments originating in the U.S.[5] In contrast to distributors that purchase other tobacco products from a different entity, some companies both manufacture or import and distribute tobacco products (manufacturer-distributors). In this circumstance, there is no arm's-length transaction between the supplier and the distributor that establishes the wholesale cost of the product, and thus it is more challenging to determine the amount that should be taxed.

CDTFA has found that some other tobacco product distributors have attempted to manipulate the wholesale cost on which they are taxed even when an arms-length transaction occurs. For example, in 2020 CDTFA audited a distributor that directed one of its suppliers to separately invoice most of the cost of other tobacco products as an intellectual property fee. The distributor did not report these costs as a part of its wholesale cost. CDTFA's audit found that other suppliers were similarly invoicing part of the cost for other tobacco products as an intellectual property fee and not

[5] An arm's-length transaction is a sale entered into in good faith and for valuable consideration that reflects the fair market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction.

as part of the wholesale cost. CDTFA informed the distributor that it owed an additional $1.4 million in tax, interest, and penalties. According to an administrator in CDTFA's Audits and Examination Branch (audits administrator), the distributor ceased operations and currently owes more than the original amount because of interest charges.

Figure 7
Multiple Entities Are Involved in the Production and Sale of Other Tobacco Products


Importer
An importer is a purchaser for resale of other tobacco products manufactured outside the U.S. for the purpose of making a first sale or distribution within the U.S.
Manufacturer
A manufacturer is a producer of other tobacco products sold in California, such as a box of cigars.
Distributor
A licensed California distributor buys the product. The distributor pays OTP tax on the cost it paid, prior to any discounts or trade allowances.
Retailer
A tobacco retailer sells the product directly to the public.
Consumer
The public purchases the product.

Source: State law, CDTFA regulations, CDTFA publications, and CDTFA's website.
Note: A single entity may fill one or more of the roles above.

State regulations authorize manufacturer-distributors to use one of several methods of determining the wholesale cost, as Figure 8 shows. Under each method, the wholesale cost includes five factors: all manufacturing costs, as the text box describes; the cost of raw materials; the cost of labor; any federal excise or U.S. customs taxes paid; and certain freight or transportation charges. Because of the complexity involved in calculating the wholesale cost in these instances, we focused our review on how CDTFA confirmed the wholesale costs reported by manufacturer-distributors.

Despite the importance of establishing an accurate wholesale cost to which the OTP tax is applied, CDTFA rarely reviews the wholesale costs that manufacturer-distributors calculate to determine whether they are paying the correct amount of OTP taxes. State law requires tobacco tax licensees to retain records created in the normal course of business and allows CDTFA to examine any books or records of any person dealing in tobacco products, and CDTFA completed 408 cigarette and tobacco tax audits during fiscal years 2019–20 and 2020–21. According to information provided by the audits administrator, 11 of these audits involved entities that were manufacturer-distributors during those fiscal years. For four of the 11 audits, CDTFA provided documentation of an analysis of wholesale costs. However, these audits used estimates for portions of the wholesale costs and CDTFA generally did not obtain sufficient documentation to confirm the accuracy of the amounts.

Expenses That Are Incorporated in the Manufacturing Costs of Manufacturer-Distributors' Other Tobacco Products

Manufacturing costs include all overhead expenses that are directly or indirectly attributable to the production of finished other tobacco products, which may include the following:

- Production and administrative salaries.
- Depreciation.
- Repairs and maintenance.
- Rent and utilities for production facilities.
- Equipment.

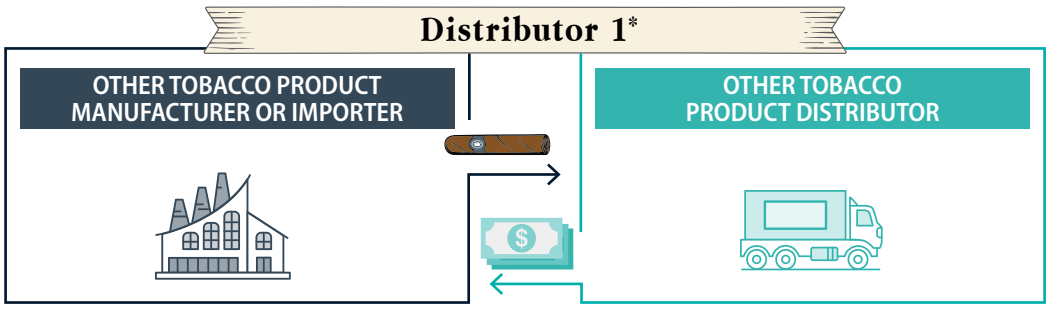
Manufacturing costs do not include overhead expenses not attributable to producing finished tobacco products, such as salaries and expenses for business activities involving the following:

- Selling.
- Distribution.
- Marketing.
- Finance.
- Information technology.
- Human resources.
- Legal activities.

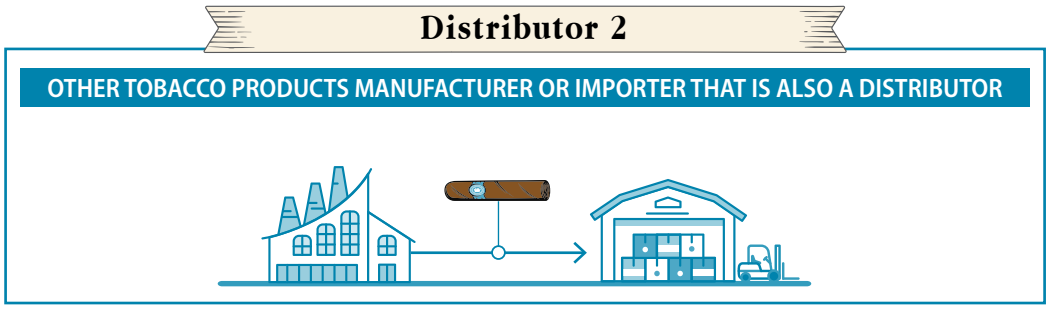
Source: State law.

Specifically, for three of the four audits, CDTFA used estimates for the manufacturer-distributor's overhead costs when determining the wholesale costs of the other tobacco products, and in the fourth audit, it accepted the distributor's estimate of its overhead costs without any documentation. Overhead costs are the expenditures not directly associated with the creation of a product or service, such as rent and utilities for production facilities. CDTFA's audits administrator stated that the department used an estimate of the overhead costs incurred by a manufacturer-distributor when the records were not reasonably attainable or traceable to the manufacturing portion of the business. He further explained that prior management had directed audit staff to apply an overhead cost estimate of 6 percent to the direct costs of producing the product. However, he indicated that CDTFA had no documentation to support the reasonableness of the estimate; thus, it is unclear how CDTFA determined that this estimate was appropriate.

Figure 8
Methods for Calculating Other Tobacco Product Wholesale Costs Differ Depending on the Nature of the Transaction



METHOD FOR CALCULATING WHOLESALE COST: Amount paid for the product, including federal excise tax but excluding any transportation charges for shipments originating within the U.S. Discounts and trade allowances must be added back when determining the wholesale cost.



METHOD FOR CALCULATING WHOLESALE COST:

- All manufacturing costs, the cost of raw materials prior to any discounts or trade allowances, the cost of labor, and any federal excise and U.S. Customs taxes paid.
- A publicly or commercially available price list that the distributor used to determine the prices of tobacco products sold to customers in arm's-length transactions during the time period at issue, less an estimate based on best available information of the distributor's or a similarly situated distributor's profit.
- If those price lists are not available, industry data from the time period to be estimated or calculated that provides reasonable evidence of typical other tobacco product costs may be used, including:
  - Evidence reasonably indicative of the typical costs of the same or similar tobacco products for similarly situated distributors, with appropriate adjustments.
  - The price of the same or similar tobacco products as reflected in a supplier's price list, with appropriate adjustments.
  - The retail price of the same or similar tobacco products as reflected in a retailer's price list, with appropriate adjustments, less reasonable estimates of the retailer's and distributor's profits.

In certain circumstances, distributors that are not manufacturers or importers may also use these methods for calculating wholesale cost.

Source: State law.

* Supplier and distributor are involved in an arm's-length transaction.

Without information about the actual costs that manufacturer-distributors incur, CDTFA may be reaching inaccurate conclusions about the amount of OTP taxes that they owe. The audits administrator stated that the amount of time CDTFA spends to substantiate the overhead cost is dependent on the availability of records and the impact of overhead costs on the wholesale cost. However, it is not clear how CDTFA was able to determine the impact of the overhead costs without documentation to substantiate those costs.

In addition, *CDTFA did not obtain documentation to substantiate the labor costs the manufacturer-distributors attributed to their manufacturing process for any of the four audits we reviewed.* Labor costs include employee wages as well as the cost of employee benefits and payroll taxes paid by an employer. CDTFA's audits administrator stated that during an audit, CDTFA's review is limited to the types of records maintained by the taxpayer and that CDTFA makes reasonable estimates when payroll records are missing. The documentation for two of CDTFA's audits suggests that it estimated labor costs based on the amount of time it takes to produce a tobacco product multiplied by California's minimum wage. However, even if the manufacturer-distributor was paying its employees minimum wage, the estimates were lower than warranted because CDTFA did not include other elements of labor costs, such as state and federal payroll taxes. If CDTFA determined that payroll records were not available, it could have calculated the estimated amounts of state and federal payroll taxes and other payroll costs to determine a more accurate cost of labor. In these instances, a more reasonable cost of labor would have increased the wholesale cost and thus the amount of OTP tax owed for the products.

Finally, for one audit, CDTFA did not obtain documentation to substantiate a number of costs described in regulations because the manufacturer-distributor was unwilling to provide them. Instead, CDTFA relied on amounts supplied by the manufacturer-distributor, such as the costs of freight, duties, and tariffs, without obtaining supporting documentation. As we discuss earlier, the wholesale cost includes five factors. However, during its audit, the only documentation CDTFA obtained was for some of the costs of the materials used in the production of the products. CDTFA's audits administrator stated that the department repeatedly attempted to obtain documentation of the other costs, but the manufacturer-distributor was unwilling to provide them.

The audits administrator stated that CDTFA determined that the manufacturer-distributor had overestimated its wholesale cost; therefore, CDTFA did not deem it necessary to collect additional documentation. Specifically, despite the manufacturer-distributor's refusal to provide documentation to support its wholesale cost, CDTFA concluded that the manufacturer-distributor had overstated its wholesale cost and had overpaid $2.2 million in OTP taxes. However, it is unclear how CDTFA was able to make this determination without obtaining sufficient documentation. Further, the manufacturer-distributor's refusal to supply supporting documentation calls into question the figures it provided. CDTFA has the authority to issue an administrative subpoena to compel taxpayers to provide documentation, but the audits administrator stated that to his knowledge, CDTFA has not used a subpoena for a tobacco audit.

CDTFA could also avail itself of the criminal justice system. According to state law, any person who fails or refuses to provide data required by CDTFA or to allow an inspection by CDTFA is guilty of a misdemeanor. Thus, CDTFA could refer an entity for criminal prosecution that does not comply with its requests to provide documentation. Despite such authority, the audits administrator explained that CDTFA does not often refer these cases for criminal prosecution because of the difficulty in identifying a district attorney willing to prosecute them. However, unless CDTFA begins using the mechanisms that state law places at its disposal for enforcing its authority, manufacturer-distributors will have little incentive to provide the documentation necessary to verify the wholesale costs on which OTP taxes are based.

CDTFA Began Using More Accurate Data to Calculate the OTP Tax Rate, Resulting in an Additional $45 Million in Estimated Tax Revenue

In our 2021 audit, we determined that the data CDTFA used to calculate the average wholesale cost of cigarettes was outdated and incomplete, resulting in CDTFA's collecting less OTP tax revenue than it should have. *In response to our recommendations, CDTFA used a new, more precise source of data for calculating the fiscal year 2021–22 OTP tax rate. We estimate that this change increased the State's OTP tax revenue by $45 million in that year.*

CDTFA based its previous calculation on a tobacco manufacturers association's data on the wholesale price of premium cigarettes and the estimated wholesale markup rate. In our previous audit, we identified two issues with CDTFA's source of data. First, when using the association's data, CDTFA excluded discount cigarettes from its calculation of the average price per pack of cigarettes. Excluding these types of cigarettes increased the average wholesale price of cigarettes used in the tax calculation. Second, CDTFA applied a distributor markup rate that was out of date and higher than more current sources. Both elements contributed to an increase in the price per pack of cigarettes that CDTFA used in its calculation, which resulted in a lower OTP tax rate.

The data CDTFA now uses are more current and accurate. CDTFA now determines the average wholesale cost of cigarettes by using cigarette sales that cigarette manufacturers and importers report to it. As Table 1 illustrates, CDTFA would have calculated an OTP tax rate of 53.4 percent for fiscal year 2021–22 had it used its previous data source. Using its new data source, CDTFA calculated the OTP tax rate for fiscal year 2021–22 to be 63.49 percent. Applying this tax rate to the reported $447 million of wholesale costs subject to OTP tax in fiscal year 2021–22 yielded $284 million in OTP tax revenue. This amount is an estimated $45 million more than CDTFA would have collected had it calculated the OTP tax rate using its previous data source, as Table 1 shows.

Table 1
CDTFA's Use of More Accurate Wholesale Cost Data Has Resulted in an Additional $45 Million in Tobacco Tax Revenue in Fiscal Year 2021–22

	CDTFA WHOLESALE COST CALCULATION		ADDITIONAL REVENUE
Source of Data	Tobacco association data plus estimated wholesale markup	Cigarette manufacturer and importer reported cigarette sales price	
OTP tax rate	53.40%	63.49%	
Amount subject to OTP taxes	**$447 million**		
Calculated OTP tax revenue	$239 million	$284 million	$45 million

Source: Fiscal year 2021–22 CDTFA tobacco products rate memorandum; tobacco manufacturer, importer, and distributor tax return data; and Tobacco Manufacturers Association report on premium cigarette prices.

Please refer to the section beginning on page 3 to find the recommendations that we have made as a result of these audit findings.

The Six Entities We Reviewed Posted the Required Proposition 56 Information on Their Websites, but Five Did So Inaccurately

Key Points

- In compliance with state law, all six entities we reviewed posted information on their websites about the amounts of Proposition 56 funds they received and spent. However, five of them did so inaccurately, potentially misinforming the public.

- In addition to posting information on their websites, state law requires each entity to post information about the amount of Proposition 56 funds received and spent on the social media platforms they deem appropriate. Two entities posted this information on their social media platforms, while three others did not deem their social media platforms appropriate for doing so. The other entity declined to state whether it had deemed its social media platforms appropriate for this information, and we were therefore unable to conclude that it complied with the law.

Although All Six Entities Posted Proposition 56 Information on Their Websites, Five Inaccurately Posted the Amounts of Proposition 56 Funds They Received or Spent

State law requires each state entity that receives Proposition 56 funds to annually publish on its website how much of those funds it received and how that money was spent. In our 2021 audit, we found that most of the six entities we reviewed that received Proposition 56 funds had not reported information for fiscal years 2017–18 and 2018–19 in a timely manner, limiting the public's ability to monitor the entities' use of these funds. The entities provided various reasons for these past failures, including staff turnover, waiting for the State's accounting system to close for the year, and the lack of a due date in the law for posting the information. Although Proposition 56 does not define a specific date by which entities must publish this information, we recommended in our 2021 audit that the entities publish information by April 2021 for fiscal year 2019–20 and by the following December for all subsequent fiscal years.[6]

In our current audit, we found that the California Department of Public Health (CDPH), the California Department of Education (Education), DHCS, Justice, UC, and CDTFA had posted information on their websites about the amounts of Proposition 56 funds they received and spent. Further, all six entities posted the information for fiscal year 2020–21 by December 2021, providing the public with timely information on the amounts of Proposition 56 funds they had received and spent.

[6] Because the State Controller generally required entities to submit all of their year-end financial reporting within four months of the end of the fiscal year at the time we made that recommendation, the dates we recommended provide entities with a reasonable amount of time to gather and compile the information to post on their websites.

However, five of the entities posted amounts to their websites for fiscal year 2019–20, fiscal year 2020–21, or both years that may have misinformed the public. These postings occurred largely because the entities relied on inaccurate sources of information to determine the amount of funds they received. Relying on these inaccurate sources was unnecessary; *because information on the actual amounts of Proposition 56 funds the entities receive becomes available no later than one month after the close of each fiscal year, the entities have ample time to obtain and post that information to their websites.*

For example, three programs at CDPH that receive Proposition 56 funds reportedly each used different sources of financial information and, as a result, CDPH reported receiving about $152 million in total for fiscal year 2019–20 when it actually received about $163 million. Only one of CDPH's programs correctly posted the actual amount of money it received for fiscal years 2019–20 and 2020–21. According to CDPH's assistant chief of its financial management branch, two programs used budgetary information and the third program was unable to determine the source of the information it used because the employees with that knowledge had left the program.

Other entities posted information to their websites based on estimates of the amounts they were to receive rather than reporting the actual amounts they received. For example, Justice reported that it had received $38.5 million in Proposition 56 funds in fiscal year 2019–20, but it actually received only $34.2 million. A manager at Justice stated that when posting the amount of Proposition 56 funds it receives each year, Justice uses budgetary information. Although the amount Justice posted correctly reflected the budgetary estimates, it was not the amount Justice received and thus did not comply with state law.

Similarly, DHCS reported receiving more than $1.2 billion in Proposition 56 funds in fiscal year 2019–20, rather than the $954 million it actually received. According to DHCS's chief of financial management, DHCS posted budgetary estimates from Medi-Cal documents rather than the amounts it received because it viewed this information as being more relevant to the goals of the department's Proposition 56 programs.

In addition, because Education used budgetary estimates, it reported receiving about $17.9 million in allocations in fiscal year 2019–20 when it actually received nearly $22.7 million. Education again underreported the amount it received in fiscal year 2020–21, in this case by about $1.7 million. According to a staff services manager for Education's Tobacco-Use Prevention Program, Education believed the reports it used met the objectives of the law and presented the best portrayal of Proposition 56 amounts. However, because these reports used budgetary estimates rather than actual amounts received, they did not align with the requirements of the law.

CDTFA also reported budgetary estimates rather than the actual amounts it received, misrepresenting the extent of its available resources. CDTFA receives and expends amounts from two Proposition 56-related funds. According to CDTFA, the amount of funds it receives in each fund is consistent with the amount it expends, so it reports its expenditures. However, this method of accounting for expenditures is true for only one of the two funds. For the other, the amount of revenue the fund receives is

a specific amount that is not tied to expenditures. The expenditures for this fund are therefore not equivalent to the amount it received. Consequently, in fiscal year 2020–21, CDTFA reported that it had received $4.5 million in funding to administer and enforce Proposition 56, when it had actually received about $6.3 million.

Finally, although CDTFA, Justice, and Education generally posted accurate expenditure information on their websites, CDPH and DHCS did not. CDPH reported spending about $174 million for fiscal year 2019–20, yet it actually spent about $228 million. Similarly, CDPH reported spending about $128 million for fiscal year 2020–21 when it actually spent $166 million. As we describe above, CDPH posted financial information from a variety of sources to its website and was not able to verify the source for some of this information. Moreover, DHCS incorrectly summarized expenditure items on its website, resulting in a $102 million overstatement of its fiscal year 2019–20 expenditures. By inaccurately reporting the amounts of Proposition 56 funds they spent, CDPH and DHCS prevented the public from correctly understanding their use of those funds.

Four of the Six Entities Did Not Use Their Social Media Platforms to Report the Amount of Proposition 56 Funds They Received and Spent

State law requires each state entity that receives Proposition 56 funds to post information about the funds it received and spent on the social media platforms it deems appropriate. When we questioned UC, CDPH, and Justice, they each asserted that it did not believe social media was appropriate for this type of information. In contrast, CDTFA and Education each posted information after we brought this requirement to its attention. CDTFA posted a link to the funds it received and spent for fiscal year 2020–21 on its Facebook and Twitter accounts. Similarly, Education posted links on Facebook to the amounts of Proposition 56 funds it received and spent for fiscal years 2019–20 and 2020–21. According to an education administrator at Education's Tobacco-Use Prevention Education Office, Education will continue sharing this information annually.

In contrast, DHCS declined to state whether it deemed its social media accounts appropriate for posting the amount of Proposition 56 funds it received and spent, so we were unable to determine whether it complied with state law. DHCS's deputy director of communications confirmed that DHCS did not post Proposition 56 information on its social media accounts for fiscal years 2019–20 and 2020–21. When we asked whether DHCS had deemed the information not appropriate for its social media accounts, the deputy director of communications described some of the types of information that his department posts on its social media platforms. However, despite our repeated inquires, he would not confirm whether DHCS believed the Proposition 56 expenditure and revenue information was not appropriate for its social media accounts or whether DHCS had previously performed such an assessment.

Please refer to the section beginning on page 3 to find the recommendations that we have made as a result of these audit findings.

Other Area We Reviewed

Distribution of Proposition 56 Funds

In our 2021 audit, we found that the budget act appropriated amounts to CDPH and Education that were greater than the agencies' proportional share of the actual revenues collected. Specifically, for fiscal year 2017–18, the budget act appropriated specific amounts for the four entities that receive a percentage of Proposition 56 revenue: DHCS, CDPH, Education, and UC. However, the variable allocations for CDPH and Education were transferred into a single fund. CDPH subsequently spent or obligated nearly all of the fiscal year 2017–18 funds it was appropriated, which was $2.5 million more than its proportional share of the actual revenue. As a result, CDPH spent more of the funds than it was entitled to, at Education's expense.

In our current audit, we found that Education does not have access to the fund into which the $2.5 million was deposited. Moreover, this fund also holds more than $15 million in Proposition 56 funds remaining from Education's prior year allocations that Education cannot access, even though it has the legal authority to spend the funds. Although certain funds must be expended or encumbered by an agency within three years, the funds from Proposition 56 are continuously appropriated, meaning that an agency's authority to expend or encumber them does not expire. However, the Department of Finance (Finance) did not designate these Proposition 56 funds as exempt from the three-year expenditure and encumbrance deadline in the State Controller's system; consequently, the system shows that Education's ability to expend or encumber them expired after three years. Finance completed an analysis of the amounts expended from the fund in October 2022 and intends to issue an executive order to transfer the $15 million to Education. In addition, it has been in discussions with CDPH to pay back the amount owed to Education.

Please refer to the section beginning on page 3 to find the recommendations that we have made as a result of these audit findings.

We conducted this performance audit in accordance with generally accepted government auditing standards and under the authority vested in the California State Auditor by Government Code section 8543 et seq. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

MICHAEL S. TILDEN, CPA
Acting California State Auditor

November 29, 2022

Appendix

Scope and Methodology

We conducted this audit pursuant to the audit requirement in Revenue and Taxation Code section 30130.56. Specifically, we reviewed the calculation of Proposition 56 taxes, how the funds were distributed, whether DHCS used the funds it received for appropriate purposes, and whether state agencies complied with the reporting and administrative cost requirements of Proposition 56. The table lists the audit's objectives and the methods we used to address them.

Audit Objectives and the Methods Used to Address Them

	AUDIT OBJECTIVE	METHOD
1	Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed and evaluated laws and regulations related to tobacco taxes, Medi-Cal, and CDTFA's audit authority.
2	Evaluate CDTFA's processes for collecting and distributing the appropriate funds to entities specified in state law.	• Reviewed CDTFA's policies and procedures and interviewed staff to determine how CDTFA ensures that it collects tobacco tax funds appropriately. • Quantified the impact of CDTFA's changes to the source of data it used to calculate the OTP tax rate for fiscal year 2021–22. • Determined the number of cigarette and other tobacco product tax audits CDTFA completed during fiscal years 2019–20 and 2020–21 and evaluated its other tobacco product tax audit process. • Evaluated the appropriateness of CDTFA's process for calculating backfill allocations for fiscal years 2019–20 and 2020–21. • Reviewed the State Controller's policies and procedures to determine how it allocates and transfers funds to state agencies and assessed whether it has appropriate safeguards over this process. • Identified the amount of Proposition 56 funds distributed to each state entity for fiscal years 2019–20 and 2020–21.
3	For Proposition 56-funded Medi-Cal supplemental payments, review and assess whether DHCS paid the funds to eligible providers.	Selected DHCS's Proposition 56 programs that made supplemental payments to providers for specific medical services and determined the following: • Whether the total number of Proposition 56 services in the managed care plans' quarterly reports matched the number of services provided in their medical encounter data during fiscal years 2019–20 and 2020–21. • Whether managed care plans appropriately made Proposition 56 supplemental payments to providers for medical services by selecting 149 services provided during fiscal years 2019–20 and 2020–21 from the managed care plans' quarterly reports and encounter data and matching them to beneficiary medical records. • Whether DHCS reimbursed claims submitted by suspended or ineligible fee-for-service providers during fiscal years 2019–20 and 2020–21. • Whether the encounter records managed care plans identified in response to our requests matched a selection of 60 services from the managed care plans' quarterly reports.

continued on next page . . .

	AUDIT OBJECTIVE	METHOD
4	Determine whether each entity published on its website the appropriate amount of tax revenue it received and how it spent the money in fiscal years 2019–20 and 2020–21 and whether each state agency or department posted on its social media accounts that those annual accountings were available.	• Reviewed the website of each of the agencies receiving Proposition 56 funds as of December 2021 and determined whether the agencies had published information regarding the Proposition 56 revenue they received and spent in fiscal years 2019–20 and 2020–21. • Identified the revenue and expenditure amounts the agencies published and verified whether the amounts they reported were accurate. • Determined whether the agencies receiving Proposition 56 funds deemed it appropriate to post on their social media platforms information regarding the Proposition 56 revenue they received and spent and, if so, whether they did so for fiscal years 2019–20 and 2020–21.
5	Determine whether each state entity that administers the funds used the appropriate amount of administrative funds as specified in state law during fiscal years 2019–20 and 2020–21.	Identified the Proposition 56 funds each agency spent on administrative costs for fiscal years 2019–20 and 2020–21 and concluded that the proportions were less than 5 percent of the total amount they received, as required by state law.

Source: Audit workpapers.

Factors Related to Auditor Independence

Revenue and Taxation Code section 30130.57(g) required the State Auditor to promulgate regulations to define *administrative costs* for the purposes of the California Healthcare, Research and Prevention Tobacco Tax Act of 2016. The regulations that define those administrative costs, 2 CCR §§ 61200-61217, became effective March 14, 2018, and were used as criteria for this audit.

Assessment of Data Reliability

The U.S. Government Accountability Office, whose standards we are statutorily obligated to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or recommendations.

In performing this audit, we relied on encounter data and managed care plans' quarterly report data we obtained from DHCS. To evaluate these data, we reviewed existing information about the data, interviewed staff members knowledgeable about the data, and performed electronic testing of the data. In addition, we performed electronic analysis to match encounter data with the managed care plans' quarterly report records. However, we found significant discrepancies between the managed care plans' quarterly report records and the encounter data when we tried to match records using the provider information, and we were unable to perform any matching at the beneficiary level because the managed care plans' quarterly reports do not contain beneficiary information. We attempted to obtain documentation to ascertain the accuracy of the encounter data but, as we discuss in this report, the managed care plans did not provide supporting documentation for all of the items we selected. As a result, we determined that the encounter data and the managed care plans' quarterly report data were of undetermined reliability. Although we recognize

that data limitations may affect the precision of some of the numbers we present, there is sufficient evidence in total to support our audit findings, conclusions, and recommendations.

We obtained data from the Financial Information System of California (FI$Cal) and the State Controller to determine the amounts of funds agencies spent on administrative costs and the amounts of Proposition 56 taxes collected and distributed to agencies during fiscal years 2019–20 and 2020–21. We conducted interviews with staff knowledgeable about the accounting data and reviewed source documents. Additionally, a report our office issued in February 2022 identified findings in FI$Cal's overall information technology general controls environment during fiscal year 2019–20.[7] These deficiencies resulted in pervasive risks that could impact the ability to rely on FI$Cal data used for financial reporting. As a result, we determined that these data are of undetermined reliability. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

We obtained data from Justice's internal accounting system to determine the amounts of Proposition 56 funds it spent on administrative costs during fiscal years 2019–20 and 2020–21. To assess the accuracy of these data, we reviewed a selection of expenditures and determined whether Justice classified them appropriately. To assess the completeness of these data, we reviewed Justice's accounting data and determined whether they matched totals in the State Controller's reporting system. Based on these determinations, we found the data sufficiently reliable for our purposes.

We obtained data from UC's internal accounting systems to determine the amounts of Proposition 56 funds it spent on administrative costs during fiscal years 2019–20 and 2020–21. To assess the accuracy of these data, we reviewed a selection of expenditures and determined whether UC classified them appropriately. Based on this selection, we found the data from UC's internal accounting systems to be of undetermined reliability. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings and conclusions for UC.

We obtained data from CDTFA's centralized revenue opportunity system to determine the number and type of cigarette and tobacco audits CDTFA completed during fiscal years 2019–20 and 2020–21. We performed dataset verification procedures, and to assess the accuracy of these data, we reviewed a selection of audit reports and determined their issue dates. As a result, we concluded that the data are of undetermined reliability. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

[7] *State of California: Internal Control and Compliance Audit Report for the Fiscal Year Ended June 20, 2020*, Report 2020-001.1.

We obtained data from CDTFA's cigarette tax reporting system on the cigarette sales that cigarette manufacturers and importers reported in fiscal year 2021–22 and that CDTFA uses to determine the average wholesale cost of cigarettes. We performed dataset verification procedures and electronic testing of key data fields. As a result, we concluded that the data are of undetermined reliability. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

We obtained a DHCS tracking log showing key dates for mandatory provider suspensions from the Medi-Cal program from 2019 through 2021. We used these data to determine the average number of months DHCS took to issue mandatory suspensions to providers. We performed electronic testing of key fields from our analysis and found them to be reasonable and consistent with other data. Consequently, we found the tracking log data to be sufficiently reliable for the purposes of determining the average number of months that DHCS took to process mandatory suspensions.

We obtained data from the California Health and Human Services open data portal to determine the number of adult deaths from smoking-related illnesses in California in 2019. Because these data were used for contextual information and do not materially affect findings, conclusions, or recommendations, we determined that a data reliability assessment was not necessary.

We obtained DHCS Proposition 56 allocation and expenditure data for fiscal years 2019–20 and 2020–21 to determine which programs received and spent Proposition 56 funds. DHCS compiled this information from multiple systems. Because of the number of systems involved, it was not cost-effective to conduct a data reliability assessment. As a result, we concluded that the data are of undetermined reliability. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

CALIFORNIA DEPARTMENT OF EDUCATION

TONY THURMOND
STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

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November 4, 2022

Michael S. Tilden, CPA*
Acting California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Subject: *Proposition 56 Tobacco Tax, Report 2021-046*

Dear Mr. Tilden:

The California Department of Education (Education) appreciates the opportunity to provide comments and address the recommendations outlined in the California State Auditor's (CSA) Audit Report titled, *Proposition 56 Tobacco Tax.*

Recommendation 1

To provide more accurate information to the public, each entity should report on its website the amount of Proposition 56 funds that it actually received beginning with information reported for fiscal year 2021-22.

Education's Comments

Concur with reservations. To clarify, Education used the amounts identified in the State Budget for the total amount of Proposition 56 funds received. However, the CSA obtained a report from the State Controller's Office (SCO) that reflected a different amount received by Education for this fund. After Education conferred with the CSA extensively, it was determined that the information in the SCO report should be used for the total amount received for the Proposition 56 funds; however, this is not currently a report that Education receives. Education is committed to providing the most accurate information to the public and if we are able to receive the report from the SCO, we will post to our website the actuals for funds received beginning with fiscal year 2021-22. ①

Recommendation 2

When Education begins to post information to its website about the amounts of Proposition 56 funds they have received and spent, they should also post links to that information on their social media platforms to increase transparency.

Education's Comments

Concur. Education will post links to its website on social media platforms to increase transparency regarding the amounts of Proposition 56 funds received and spent.

* California State Auditor's comment appears on page 45.

If you have any questions regarding Education's comments, please contact Alice Lee, Director, Audits and Investigations Division, by phone at 916-323-1547 or by email at AlLee@cde.ca.gov.

Sincerely,

Mary Nicely
Chief Deputy Superintendent of Public Instruction

MN:kl

Comment

CALIFORNIA STATE AUDITOR'S COMMENT ON THE RESPONSE FROM THE CALIFORNIA DEPARTMENT OF EDUCATION

To provide clarity and perspective, we are commenting on the response to our audit from Education. The number below corresponds to the number we have placed in the margin of the response.

The amount of Proposition 56 tobacco taxes available for allocation varies from year to year, and because the taxes are collected after the budget is passed, the amounts estimated in budget documents do not reflect the amount Education ultimately receives. Thus, Education's approach of reporting budgeted amounts does not align with the law's requirement to report the amount of funds that it actually receives. ①

DEPARTMENT OF FINANCE
Gavin Newsom ▪ Governor
1021 O Street, Suite 3110 ▪ Sacramento CA 95814 ▪ www.dof.ca.gov

November 4, 2022

Michael S. Tilden*
Acting California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

The California Department of Finance (Finance) submits the below response to the draft audit report 2021-046, the biennial California Healthcare, Research and Prevention Tobacco Tax Act of 2016 (Proposition 56) financial audit. The California State Auditor (Auditor) identified two recommendations related to Finance. Finance has developed a plan to address the recommendations.

Background

Proposition 56, passed by voters on November 8, 2016, requires 13 percent of revenue to be allocated for the purpose of funding comprehensive tobacco prevention and control programs, with 85 percent allocated to the California Department of Public Health (Public Health) and 15 percent allocated to the California Department of Education (Education). Fiscal year 2017-18 was the first year Proposition 56 revenues were available for expenditure and the 2017 Budget Act appropriated funding for Public Health and Education based on estimated Proposition 56 revenue. Standard expenditure and liquidation periods applied to the Budget Act appropriation. The Tobacco Prevention and Control Programs Account, California Healthcare, Research and Prevention Tobacco Tax Act of 2016 Fund (Fund 3309) was created to deposit the 13 percent revenue.

Finance's responsibility related to Proposition 56 is to budget expenditures based on estimated revenue using the best available point-in-time information. These estimates are incorporated into the respective year's budget and Finance sends a revenue transfer schedule to the California State Controller (Controller) based on the budget estimates. As specified in Revenue and Taxation Code Section 30130.55, the Controller is required to transfer actual Proposition 56 revenues received in accordance with the Proposition 56 percentage schedule. The Controller, along with Public Health and Education, are responsible for monitoring the Proposition 56 expenditures based on the actual and available revenue deposited. ①

Beginning in fiscal year 2018-19, each entity receiving a percentage share of Proposition 56 revenue was provided its own continuously appropriated Proposition 56 subaccount. Under this structure, Public Health and Education's proportional share of the 13 percent for tobacco prevention and control programs is deposited separately in their respective subaccounts.

* California State Auditor's comment appears on page 51.

Michael S. Tilden
November 4, 2022
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Audit Recommendations

"To ensure that Education receives its proportional share of Proposition 56 funds, the Department of Finance (Finance) should determine the amount of fiscal year 2017-18 Proposition 56 funds that Education is owed and transfer those funds from CDPH to Education by June 2023.

To ensure Education can spend the funds that it was allocated in prior fiscal years, Finance should transfer the unspent portion of these funds to an account that Education can access by June 2023. Further, it should inform Education the funds are available to be spent."

Finance's Response

In the report 2019-046 released in January 2021, the Auditor recommended "Education should negotiate with Finance and Public Health to ensure that it receives the full amount of its proportional share of fiscal year 2017-18 Proposition 56 funds." As the entity assisting to provide a solution to the report 2019-046 finding and the recommendations noted in report 2021-046, Finance has been working with Education and Public Health to address the recommendations since report 2019-046 was issued in January 2021. However, until all transaction activity in the shared Proposition 56 account ceased with the close of the 2021-22 fiscal year on June 30, 2022, Finance did not have complete expenditure data to finalize an analysis to assist Education and Public Health. With the close of the 2021-22 fiscal year, Finance independently analyzed and validated the 2017-18 Proposition 56 revenue allocation and expenditures and provided its final analysis plan to address the report 2019-046 recommendations to the Auditor on October 24, 2022.

To assist Education in receiving its proportional share of 2017-18 Proposition 56 revenue, Finance will do the following:

1. Issue an Executive Order to transfer the $15.2 million remaining in Fund 3309 to the Department of Education Subaccount, Tobacco Prevention and Control Programs Account, CA Healthcare, Research and Prevention Tobacco Tax Act of 2016 Fund (Fund 3321) by June 2023.

2. Due to concerns related to declining Proposition 56 revenue and existing budgetary commitments, it is anticipated Public Health will pay the $2.7 million overspent in fiscal year 2017-18 to Education across two fiscal years beginning July 2023, subject to the budget process. The funds will be transferred from the Department of Public Health Subaccount, Tobacco Prevention and Control Programs Account, CA Healthcare, Research and Prevention Tobacco Tax Act of 2016 Fund (Fund 3322) to Fund 3321.

With these two actions, Education will receive and be able to spend the $17.9 million of its proportional share of 2017-18 Proposition 56 revenue.

Michael S. Tilden
November 4, 2022
Page 3

If you have any questions regarding Finance's comments, please contact Andrew Duffy, Principal Program Budget Analyst, by phone at 916-445-6423 or by email at Andrew.Duffy@dof.ca.gov.

Sincerely,

JOE STEPHENSHAW
Director

Comment

CALIFORNIA STATE AUDITOR'S COMMENT ON THE RESPONSE FROM THE CALIFORNIA DEPARTMENT OF FINANCE

To provide clarity and perspective, we are commenting on the response to our audit from Finance. The number below corresponds to the number we have placed in the margin of the response.

Finance's description of the process for transferring Proposition 56 funds to state agencies does not align with the evidence it provided to us. According to documents from Finance, the amounts that it requests the State Controller to transfer are based on the amount of revenue in the tobacco tax fund, which are not budget estimates. As we describe on page 10, after the State Controller makes specific allocations, it distributes the remaining revenue to specified agencies based on percentages established in state law. ①

State of California—Health and Human Services Agency
California Department of Public Health

Tomás J. Aragón, MD, DrPH
Director and State Public Health Officer

GAVIN NEWSOM
Governor

November 3, 2022

Michael S. Tilden*
Acting California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Dear Mr. Tilden:

The California Department of Public Health (CDPH) has reviewed the California State Auditor's draft audit report titled *"Proposition 56 Tobacco Tax"*. CDPH appreciates the opportunity to respond to the report and provide our assessment of the recommendations contained therein.

Below we reiterate the recommendations pertaining to CDPH and our responses.

Recommendation #1:

To ensure that it reports accurate information to the public, CDPH should compile the expenditure information for each of its Proposition 56 programs using the same type of accounting report beginning with information reported for fiscal year 2021-22. Departments should get together and decide which basis, and which reports to use to consistently report this information. ①

Management Response:

Beginning in fiscal year 2021-22 and going forward, each of the CDPH Proposition 56 programs will use the Financial Statement Detailed Fund Balance (DF-303) Report to generate financial data to report Proposition 56 expenditure activities. CDPH is proactively working with other state departments to maintain a consistent reporting method.

Recommendation #2:

To provide more accurate information to the public, [CDPH] should report on its website the amount of Proposition 56 funds that it actually received beginning with information reported for fiscal year 2021-22.

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(916) 558-1700 ● (916) 558-1762 FAX
Internet Address: www.cdph.ca.gov

* California State Auditor's comment appears on page 55.

Michael S. Tilden
November 3, 2022
Page 2

Management Response:
Beginning in the reporting period for fiscal year 2021-22 and going forward, each of the CDPH programs that receive Proposition 56 funds will report on its website the amount of funds actually received per the Financial Statement Detailed Fund Balance (DF-303) Report. Beginning in the reporting period for fiscal year 2021-22, CDPH will discontinue reporting on closed periods and will report on the most recent budget year per Revenue and Taxation Code, Section 30130.56(c).

We appreciate the opportunity to respond to the audit. If you have any questions, please contact Mónica Vázquez, Deputy Director, Office of Compliance, at (916) 306-2251.

Sincerely,

Tomás J. Aragón, M.D., Dr.P.H.
Director and State Public Health Officer

Comment

CALIFORNIA STATE AUDITOR'S COMMENT ON THE RESPONSE FROM THE CALIFORNIA DEPARTMENT OF PUBLIC HEALTH

To provide clarity and perspective, we are commenting on the response to our audit from CDPH. The number below corresponds to the number we have placed in the margin of the response.

CDPH incorrectly stated our recommendation in its response. The text of our recommendation on page 4 of our report states the following: To ensure that it reports accurate information to the public, CDPH should compile the expenditure information for each of its Proposition 56 programs using the same type of accounting report beginning with the information it reports for fiscal year 2021–22. (1)

-STATE OF CALIFORNIA

CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION
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Governor

AMY TONG
Secretary, Government Operations Agency

NICOLAS MADUROS
Director

November 4, 2022

Michael Tilden, Acting State Auditor*
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Re: Response to California State Auditor's Draft Report: Proposition 56 Tobacco Tax-- Report 2021-046

The California Department of Tax and Fee Administration (CDTFA) appreciates the work of the California State Auditor (CSA) team. CDTFA administers the cigarette and tobacco products tax program, which generated more than $1.8 billion in annual revenue, with approximately $1.2 billion attributed to Proposition 56 in fiscal year 2021/22, and we are committed to fulfilling our obligations as accurately and efficiently as possible. Below are our responses to each of the specific items in the CSA audit report.

CDTFA Has Not Ensured That Certain Tobacco Distributors Are Paying the Appropriate Amount of OTP Tax

a. *To ensure that other tobacco product manufacturer-distributors pay the appropriate amount of OTP taxes, CDTFA should obtain sufficient documentation to verify the accuracy of those entities' wholesale costs. If these manufacturer-distributors refuse to provide necessary documentation, CDTFA should compel them to do so using the mechanisms existing in state law, such as administrative subpoenas, and it should consider referring them for criminal prosecution.*

CDTFA Response:

CDTFA will continue to ensure team members are properly trained and provided the necessary resources to obtain, review and verify taxpayer documentation that substantiates the entities' wholesale costs. In addition, CDTFA will continue to utilize all existing legal mechanisms to compel taxpayers to provide records that are not willingly provided during an audit. ①

<*Redacted*> Entities We Reviewed Posted the Required Proposition 56 Information on Their Websites, But <*Redacted*> Did So Inaccurately.

a. *To provide more accurate information to the public, each entity should report on its website the amount of the Proposition 56 funds that it actually received beginning with the information reported for fiscal year 2021-22.*

* California State Auditor's comment appears on page 59.

CDTFA Response:

Annually, CDTFA posts on its website revenues collected for that fiscal year, amounts received, and expenditures for the CA Healthcare, Research and Prevention Tobacco Tax (3304) and the Tobacco Law Enforcement Account (3319). This information was posted in accordance with CDTFA's understanding of the statutory requirements. During the engagement, the CSA team explained that CDTFA must report all funds transferred as prescribed in Revenue and Taxation Code 30130.57, into Tobacco Law Enforcement Account (3319), as money received. Beginning with fiscal year 2021-22, CDTFA will ensure its website posting includes the funds transferred from fund 3304 to fund 3319 as part of the total Proposition 56 funds received.

<*Redacted*> of the Six Entities Did Not Use Their Social Media Platforms to Report the Amount of Proposition 56 Funds They Received and Spent.

a. *When CDTFA <redacted> begin to post information to their websites about the amounts of Proposition 56 funds they have received and spent, they should also post links to that information on their social media platforms to increase transparency.*

CDTFA Response:

CDTFA posted a link to Proposition 56 summary of revenues and expenditures for fiscal year 2020-21 on its Twitter and Facebook accounts. CDTFA will continue to post links annually for Proposition 56 requirements on the social media channels CDTFA deems appropriate.

Sincerely,

Nick Maduros
Director, CDTFA

Cc: Amy Tong
Trista Gonzalez
Jason Mallet
Susanne Buehler
Tamma Adamek
Chris Lee

Comment

CALIFORNIA STATE AUDITOR'S COMMENT ON THE RESPONSE FROM THE CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION

To provide clarity and perspective, we are commenting on the response to our audit from CDTFA. The number below corresponds to the number we have placed in the margin of the response.

We disagree with CDTFA's response that its current efforts will address the concerns we identified. As we describe beginning on page 27, CDTFA rarely audits the wholesale costs of manufacturer-distributors. In the limited instances in which it conducted audits of manufacturer-distributors, it did not obtain sufficient documentation to confirm that those costs are correct, and its staff could not recall using subpoenas to compel taxpayers to provide documentation when they do not do so. Consequently, it is unlikely that the concerns we identified will be addressed if CDTFA continues to operate in the same manner, as it suggests in its response. ①

State of California—Health and Human Services Agency
Department of Health Care Services

MICHELLE BAASS
DIRECTOR

GAVIN NEWSOM
GOVERNOR

November 7, 2022

THIS LETTER SENT VIA EMAIL

Michael S. Tilden *
Acting State Auditor
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

RE: RESPONSE TO DRAFT AUDIT REPORT 2021-046

Dear Mr. Tilden:

The Department of Health Care Services (DHCS) is submitting the enclosed response to the California State Auditor (CSA) draft audit report number 2021-046 titled, "The Department of Health Care Services Is not Adequately Monitoring Provider Payments Funded By Tobacco Taxes."

In the above draft audit report, CSA issued seven recommendations for DHCS and one for the Legislature. DHCS has reviewed all of CSA's recommendations and has prepared a response describing the nature of the corrective actions taken or planned. In addition, DHCS noted certain inaccuracies in the draft audit report and CSA agrees with DHCS' edits.

DHCS appreciates the work performed by CSA and the opportunity to respond to the draft audit report. If you have any other questions, please contact DHCS Office of Compliance, Internal Audits at (916) 445-0759.

Sincerely,

Michelle Baass
Director

Enclosure
cc: See Next Page

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* California State Auditor's comments begin on page 69.

Mr. Michael S. Tilden
Page 2
November 7, 2022

cc: Jacey Cooper
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Department of Health Care Services

Audit: The Department of Health Care Services Is not Adequately Monitoring Provider Payments Funded By Tobacco Taxes

Audit Entity: California State Auditor
Report Number: 2021-046 (22-19) (Prop. 56 Tobacco Tax Audit)
Response Type: Draft Audit Report Response

Summary: The California State Auditor (CSA) issued two Findings and Recommendation 1 to the Legislature, and Recommendations 2 – 8 to the Department of Health Care Services (DHCS).

Finding 1 Department of Health Care Systems (DHCS) has not ensured the Appropriateness of Its Proposition 56 Payments and the effectiveness of its provider suspension process.

Recommendation 2
To ensure that managed care plans pay Proposition 56 supplemental payments to the appropriate providers, DHCS should require managed care plans to submit Medi-Cal beneficiary identification information with their quarterly reports by June 2023. Once DHCS obtains this information it should reconcile those reports to medical encounter data and then recover any overpayment it identifies.

DHCS Response:
DHCS is in the process of implementing changes to the quarterly reports to request additional details including beneficiary identification information. Changes are being implemented through the All-Plan Letter (APL) process and associated technical guidance.

Some variation between the two data sources is to be expected based on differences in timing, reporting lags, and scope. For example, the quarterly reports only capture contracted utilization whereas the encounter data should capture all utilization. ①

More explanation is needed for the recommendation related to recovery of overpayments. Proposition 56 supplemental payment revenues are paid to managed care plans on a risk basis, subject to the terms of payment applicable to each payment type as outlined in applicable APLs and directed payment preprints – which may include risk corridor-like structures. Therefore, it is inaccurate to consider differences between revenue received by the managed care plan and payments issued by the managed care plan as overpayments *per se*. Managed care plan responsibilities in regards to provider overpayments are outlined in APL 17-003. ②

Recommendation 3
To ensure that managed care plans issue Proposition 56 supplemental payments only when providers have actually performed the services in question, DHCS should do the following:

- By June 2023, investigate those instances in which managed care plan were unable to provide evidence that the medical services we reviewed were provided. After determining why the managed care plans lacked this evidence, it should use its corrective action plan process to implement additional monitoring and oversight of those managed care plans.

- By June 2023, begin annually selecting a sample of Proposition 56 supplemental payments of a sufficient size to ensure that it can project the results of its review to the population of services that receive supplemental payments, and requesting the underlying medical records to confirm that the services were provided.

DHCS Response:
In forthcoming audits, DHCS will perform additional audit test work to validate CSA's identified exceptions and assess the root cause of the deficiencies. The additional test work will be added to our audit scope for the next cycle of our annual managed care plan audits. Identified instances of managed care plan non-compliance will be noted as audit findings in the annual managed care plan report, and subsequent corrective action plans will require non-compliant managed care plans to perform a self-audit. ③

Additionally, DHCS has deemed managed care plan Proposition 56 supplemental payment oversight as "high-risk," and has accordingly augmented its annual managed care plan audit program to specifically test for managed care plan compliance and performance in the area. DHCS has commenced its pilot of the process, effective October 2022, and will deploy the expanded audit test work division-wide first quarter of calendar year 2023. A portion of the test work requires managed care plans to submit health records to confirm whether services were rendered.

Recommendation 4
To comply with state law, reduce the amount of time it takes to suspend providers from delivering Medi-Cal services, and better protect Medi-Cal beneficiaries from potentially ineligible providers, DHCS should, by June 2023, begin issuing temporary provider suspensions or temporary payment suspensions when permissible or required by state law, while it engages in the process of issuing a mandatory provider suspension.

DHCS Response:
DHCS is implementing measures to reduce time taken to issue mandatory suspensions, including, when appropriate, issuing temporary or payment suspensions against a provider while the mandatory suspension is pending. DHCS will work towards reducing mandatory suspension processing times by carrying out the recommendations described in the report and implementing internal monitoring of processing times on a regular basis.

1. Temporary/Payment Suspensions
    a. DHCS will modify its current mandatory suspension process to include, for those mandatory suspensions resulting from a conviction based on fraud or abuse, an internal referral to Audits and Investigations to determine whether the provider qualifies for a temporary or payment suspension.
    b. Timeframe: June 2023

2. Proactive Monitoring of Licensure Board Disciplinary Actions
    a. DHCS is currently modifying the internal processes to perform regular monthly monitoring of provider licensure board disciplinary action websites to identify providers who are ineligible to provide Medi-Cal services.
    b. DHCS has already implemented regular monitoring for the following provider types/licensure boards:
        i. Pharmacists/Pharmacies/Pharmacist Technicians (Pharmacy Board)
        ii. Registered Nurse/Public Health Nurse/Nurse Practitioner/Nurse Anesthetist (Registered Nursing Board)
        iii. Physicians/Surgeons/Osteopaths/Podiatrists/Licensed Midwives/Physicians Assistants (Medical Board)
        iv. Licensed Marriage and Family Therapist/Associated Marriage and Family Therapist/Associated Clinical Social Worker/License Clinical Social Worker/Associate Professional Clinical Counselor (Behavioral Sciences Board)
        v. Psychologists (Psychology Board)
        vi. Respiratory Care Practitioner (Respiratory Care Board)
        vii. Emergency Medical Technicians (EMT Board)
    c. DHCS is currently investigating establishing monitoring for the following provider types/licensure boards:
        i. Chiropractor (Chiropractic Examiners Board)
        ii. Dentists/Dental Assistants (Dental Board)
        iii. Hearing Aid Dispensers (Hearing Aid Dispensers Board)
        iv. Licensed Vocational Nurses/Psychiatric Technicians (Vocational Nursing and Psychiatric Technicians)
        v. Occupational Therapists (Occupational Therapy Board)
        vi. Optometrists (Optometry Board)
        vii. Physical Therapists (Physical Therapy Board)
    d. Timeframe: June 2023

Recommendation 5

To prevent providers from billing for services performed by other providers that have been suspended, DHCS should, by June 2023, revise its polices and billing to assess all rendering providers included in claim data and verify that they have not been suspended.

DHCS Response:
DHCS currently ensures the vast majority of claims submitted with suspended/ineligible providers listed on the claim are not reimbursed by DHCS. DHCS will evaluate whether policy and system changes may be made to assess all claims for data indicating the
④ services were rendered by suspended/ineligible providers. Such changes must be vetted for impacts to access to care and other downstream effects and system feasibility that may not be readily ascertainable at the time of the report.

Finding 2 Entities we reviewed posted the required Proposition 56 information on their website, but did so inaccurately.

Recommendation 6
To ensure that it reports accurate information to the public, DHCS should institute a more robust management review process for posting Proposition 56 expenditure information on its website beginning with information reported for fiscal year 2021-22.

DHCS Response:
DHCS will enhance its management review process for Proposition 56 financial information to avoid inadvertent errors prior to posting online.

Recommendation 7
To provide more accurate information to the public, each entity should report on its website the amount of Proposition 56 funds that it actually received beginning with information reported for fiscal year 2021-22.

DHCS Response:
DHCS annually posts on its website its Proposition 56 appropriations, expenditures, and amounts obligated for future fiscal years, noting the amount appropriated should have been what was received by each program. DHCS will refine its postings to reflect the amount received beginning with fiscal year 2021-22.

Recommendation 8
When [redacted] and DHCS begin to post information to their websites about the amounts of Proposition 56 funds they have received and spent, they should also post links to that information on their social media platforms to increase transparency.

DHCS Response:
Proposition 56 required in part state departments receiving funds to annually post on its website an accounting of money received and how it was spent. Further, the annual accounting shall also be posted on any social media outlets the state department deems appropriate.

DHCS' Office of Communications works with program partners to determine the appropriate platform(s) to best communicate program information to various stakeholders. DHCS regularly posts information to the DHCS website, various social media accounts, through press releases, and via stakeholder communications releases.

Per Revenue and Taxation Code section 30130.56 (c), we make daily considerations for what is deemed appropriate for posting and sharing relevant to programs funded by Proposition 56. The posts include information about Adverse Childhood Experiences (ACEs) screening, ACEs trainings, Proposition 56 Loan Forgiveness Program, and family planning.

At times, DHCS has determined that social media is not an appropriate platform, due to the nature of the communication medium. When referring to funds and budgetary actions our best practice is to provide the public with both the specific information and the larger context as appropriate within the framework of our homepage/website. (5)

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE DEPARTMENT OF HEALTH CARE SERVICES

To provide clarity and perspective, we are commenting on the response to our audit from DHCS. The numbers below correspond to the numbers we have placed in the margin of the response.

DHCS's suggestion that even after it obtains additional data there may be some variation between the two sources of data does not mitigate the issues we identified. As page 14 describes, when we reconciled the medical encounters to the managed care plans' quarterly reports for fiscal years 2019–20 and 2020–21, we found significant discrepancies. Specifically, 17 percent of the services in the fiscal year 2019–20 quarterly reports and nearly 22 percent of those in the fiscal year 2020–21 reports did not have matching records in the providers' medical encounter data. Further, as we state on page 15, when we requested that managed care plans provide the encounter records for 60 services in the managed care plans' quarterly reports, they were able to provide records for only about half of those services. Thus, we stand by our conclusion that the discrepancies we identified suggest that the managed care plans did not pay the correct provider or did not correctly record information about the service. (1)

Our recommendation is intended to align with DHCS's existing process. As we state on page 14, DHCS compares the supplemental payment amount paid through the managed care flat rate payments to the dollar amounts that managed care plans report they have paid to providers. DHCS then addresses any discrepancies between these two amounts outside of a predetermined range. If there are discrepancies outside of this range, DHCS requires the managed care plans to return the excess supplemental payment amount or receive additional funding. Our recommendation envisions DHCS obtaining and using additional data to identify these discrepancies and recovering overpayments in accordance with the process it has already established. (2)

DHCS's response does not clearly indicate when it will complete this work. We encourage DHCS to complete the work by June 2023, as we recommend, and we look forward to reviewing its progress when it provides 60-day and 6-month updates on its implementation of this recommendation. (3)

We question the considerations that DHCS cites in its rationale for determining how to identify claims rendered by ineligible providers. As we describe in the text box on page 18, state law requires DHCS to suspend providers due to a conviction of any felony or any misdemeanor involving fraud or the revocation or suspension of a license, certificate, or other approval to provide health care, among other reasons. If a provider is suspended and deemed ineligible to provide Medi-Cal services, DHCS should ensure that its system prevents payments to that provider. If DHCS believes that it should pay claims for services rendered by providers that are ineligible under existing law to avoid affecting access to care or other downstream effects, and that these impacts outweigh the risks of allowing these providers to continue serving Medi-Cal beneficiaries, it should raise these concerns to the Legislature and ask it to consider revising the law pertaining to suspending providers. (4)

⑤ In its response, DHCS provided information about its approach for determining how and what it deems appropriate for posting and sharing on social media platforms. However, DHCS does not definitively state whether it has deemed its social media accounts appropriate platforms for posting information about the amount of Proposition 56 funds it received and spent, similar to its statement that we describe on page 35. Thus, we stand by our recommendation.

ROB BONTA
Attorney General

State of California
DEPARTMENT OF JUSTICE

Division of Operations
Telephone: (916) 210-7000
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November 4, 2022

Michael S. Tilden, CPA*
Acting California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Re: Draft Audit Report - California State Auditor Report 2021-0046; Proposition 56 Tobacco Tax

Dear Mr. Tilden,

The Department of Justice (DOJ) appreciates the opportunity to review the "Proposition 56 Tobacco Tax" draft audit report.

Your audit concludes that, as required by law, DOJ has published funds received and spent for FY 2019-20 and 2020-21. We appreciate that the audit recognized DOJ's existing efforts to provide the public with information about expenditure information. However, your audit also concludes that the published information includes "budgetary estimates or inaccurate information, making it difficult for the public to determine the amount of funds that entities actually received and how two of them spent those funds." DOJ disagrees with this assessment. The appropriation information reported was neither inaccurate nor a "budgetary estimate." The annual appropriations are accurate as presented in the annual Governor's Budgets and were labeled as such on the reports. As required and consistent with the Revenue and Taxation Code Section 30130.56, DOJ has annually published on its website an accounting of the funds received from the California Healthcare, Research and Prevention Tobacco Tax Act of 2016 Fund. ① ②

The Legislature annually establishes appropriations based on the available funds. The local assistance grant awards are aligned with the annual available appropriations and not the specific annual cash transfers which are intended to maintain solvency in the fund. Reporting the cash transfers in addition to the amount appropriated could cause public confusion because the cash transfer amounts do not represent the total available funds in each year, nor do they consider the fund's reserve balance or statewide overhead charges that directly hit the fund. The public may confuse the cash transfer amounts and appropriation amounts, or incorrectly add the two together. Although DOJ remains concerned that adding this information may cause confusion, as the audit suggests, beginning with FY 2021-22, DOJ will also publish these cash transfer amounts on its website. ③

* California State Auditor's comments appear on page 73.

November 4, 2022
California State Auditor Report 2021-0046
Page 2

If you have any questions or concerns regarding this matter, you may contact me at the telephone number listed above.

Sincerely,

CHRIS RYAN
Chief
Division of Operations

For ROB BONTA
Attorney General

cc: Venus D. Johnson, Chief Deputy Attorney General
Chris Prasad, CPA, Director, Office of Program Oversight and Accountability

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE DEPARTMENT OF JUSTICE

To provide clarity and perspective, we are commenting on the response to our audit from Justice. The numbers below correspond to the numbers we have placed in the margin of the response.

The amount of Proposition 56 tobacco taxes available for allocation varies from year to year, and because the taxes are collected after the budget is passed, the amounts estimated in budget documents do not reflect the amount Justice ultimately receives. Thus, Justice's approach of reporting budgeted amounts does not align with the law's requirement to report the amount of funds that it actually receives. (1)

Although Justice asserts that it has annually published the amount of Proposition 56 funds it received, the amount reported on its website is incorrect. As we describe on page 34, Justice reported it received $38.5 million in Proposition 56 funds in fiscal year 2019–20, even though it had actually received $34.2 million. (2)

We disagree with Justice's perspective on the information it should report. As we describe on page 10, state law specifies the amounts and percentages that agencies are to receive from the tobacco tax fund—and state law continuously appropriates those funds. Thus, state law appropriates and allocates these funds without the need for further action by the Legislature or the governor, and the amounts transferred into Justice's account represent the amounts available for use. Accordingly, Justice should report the cash transfer amounts as the amounts it received. If it chooses to also report any appropriation amounts from the state budget, it should include an explanation to clearly describe the difference between the two numbers. (3)